Supreme Court, U.S.
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No. 00-825

In the
Supreme Court of the United States

OCTOBER TERM 2000

MINDGAMES, INC.

Petitioner,

v.

WESTERN PUBLISHING COMPANY, INC.

Respondent.

APPENDIX TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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In the

United States Court of Appeals

For the Seventh Circuit

No. 98-1879

MINDGAMES, INC.

Plaintiff-Appellant,

v.

WESTERN PUBLISHING COMPANY, INC.,

Defendant-Appellee.

Appeal from the United States District Court
for the Eastern District of Wisconsin.
Nos. 94 C 552, 94 C 998 -- **Lynn S. Adelman**, *Judge*

ARGUED APRIL 17, 2000--DECIDED JUNE 22, 2000
PETITION FOR REHEARING DENIED AUGUST 22, 2000

Before POSNER, *Chief Judge*, and FAIRCHILD and DIANE P. WOOD, *Circuit Judges*.

POSNER, *Chief Judge*. This is a diversity suit for breach of contract, governed by Arkansas law because of a choice of law provision in the contract. The plaintiff, MindGames, was formed in March of 1988 by Larry Blackwell to manufacture and sell an adult board game,

"Clever Endeavor," that he had invented. The first games were shipped in the fall of 1989 and by the end of the year, 75 days later, 30,000 had been sold. In March of 1990, MindGames licensed the game to the defendant, Western, a major marketer of games. Western had marketed the very successful adult board games "Trivial Pursuit" and "Pictionary" and thought "Clever Endeavor" might be as successful. The license contract, on which this suit is premised, required Western to pay MindGames a 15 percent royalty on all games sold. The contract was by its terms to remain in effect until the end of January 1993, or for another year if before then Western paid MindGames at least $1.5 million in the form of royalties due under the contract or otherwise, and for subsequent years as well if Western paid an annual renewal fee of $300,000.

During the first year of the contract, Western sold 165,000 copies of "Clever Endeavor" and paid MindGames $600,000 in royalties. After that, sales fell precipitously (though we're not told by how much) but the parties continued under the contract through January 31, 1994, though Western did not pay the $900,000 ($1.5 million minus $600,000) that the contract would have required it to pay in order to be entitled to extend the contract for a year after its expiration. In February of 1994 the parties finally parted. Later that year MindGames brought this suit, which seeks $900,000, plus lost royalties of some $40 million that MindGames claims it would have earned had not Western failed to carry out the promotional obligations that the contract imposed on it, plus $300,000 on the theory that Western renewed the contract for

a third year, beginning in February of 1994; Western sold off its remaining inventory of "Clever Endeavor" in that year.

The district court granted summary judgment for Western, holding that the contract did not entitle MindGames to a renewal fee and that Arkansas's "new business" rule barred any recovery of lost profits. 944 F. Supp. 754 (E.D. Wis. 1996); 995 F. Supp. 949 (E.D Wis. 1998). Although the victim of a breach of contract is entitled to nominal damages, *Mason v. Russenberger,* 542 S.W.2d 745 (Ark. 1976); *Movitz v. First Nat. Bank of Chicago,* 148 F.3d 760, 765 (7th Cir. 1998); E. Allan Farnsworth, *Contracts* § 12.8, p. 784 (3d ed. 1999), Mind Games does not seek them; and so if it is not entitled to either type of substantial damages that it seeks, judgment was correctly entered for Western. By not seeking nominal damages, incidentally, MindGames may have lost a chance to obtain significant attorneys' fees, to which Arkansas law entitles a prevailing party in a breach of contract case. See *Dawson v. Temps Plus, Inc.*, 987 S. W.2d 722, 729 (Ark. 1999).

The rejection of MindGames' claim to the renewal fee for the second year (and *a fortiori* the third) was clearly correct. The contract conditioned Western's right to renew the contract for a second year on its paying a renewal fee of $1.5 million (minus royalties already paid); it was silent on the terms of a renewal adopted by a new agreement of the parties rather than by the exercise of an option granted by the original contract. If MindGames hadn't wanted to renew the contract and Western had insisted, then Western would have had to pay the fee. But if Western did not invoke a

contractual right to renew, if instead the parties entered into a new agreement to renew the contract, then MindGames had no right to the renewal fee fixed in the contract; that right was *conditional* on Western's exercising its contractual right to renew. A conditional right in a contract does not become an enforceable right until the condition occurs, *Restatement (Second) of Contracts* § 225(1) (1981), unless noncompliance with the condition is excused by agreement, *Uebe v. Bowman*, 420 S.W.2d 889 (Ark. 1967); *Normand v. Orkin Exterminating Co.*, 193 F.3d 908,912 (7th Cir. 1999), or by operation of law, Farnsworth, *supra* § 8.3, p. 526, as where the other party to the contract wrongfully prevents the condition from occurring, *id.*, §8.6, pp. 544-45; *Restatement, supra*, § 225, comment b, which is not alleged, for Western had no duty to exercise its right of renewal. The condition that would have entitled MindGames to demand a renewal fee thus did not occur here; Western did not invoke its contractual right to extend the contract; after January 31,1993, the parties were operating under a new contract.

The more difficult issue is MindGames' right to recover lost profits for Western's alleged breach of its duty to promote "Clever Endeavor." A minority of states have or purport to have a rule barring a new business, as distinct from an established one, from obtaining damages for lost profits as a result of a tort or a breach of contract. E.g., *Lockheed Information Management Systems Co. v. Maximus, Inc.*, 524 S.E.2d 420, 429-30 (Va. 2000); *Bell Atlantic Network Services, Inc. v. P.M. Video Corp.*, 730 A.2d 406, 419-20 (N.J. Super. 1999); *Interstate Development Services of Lake Park, Georgia, Inc. v. Patel*, 463 S.E.2d 516 (Ga. App.

1995); *Stuart Park Associates Limited Partnership v. Ameritech Pension Trust,* 51 F.3d 1319, 1328 (7th Cir. 1995) (Illinois law); Bernadette J. Bollas, Note, "The New Business Rule and the Denial of Lost Profits," 48 *Ohio St. L.J.* 855, 859 & n. 32 (1987). The rule of *Hadley v. Baxendale,* 9 Ex. 341, 156 Eng. Rep. 145 (1854), often prevents the victim of a breach of contract from obtaining lost profits, but that rule is not invoked here. Neither the "new business" rule nor the rule of *Hadley v. Baxendale* stands for the *general* proposition that lost profits are never a recoverable item of damages in a tort or breach of contract case.

Arkansas is said to be one of the "new business" rule states on the strength of a case decided by the state's supreme court many years ago. The appellants in *Marvell Light & Ice Co. v. General Electric Co.,* 259 S.W. 741 (Ark. 1924), sought to recover the profits that they claimed to have lost as a result of a five and a half month delay in the delivery of icemaking machinery; the delay, the appellants claimed, had forced them to delay putting their ice factory into operation. The court concluded, however, that because there was no indication "that the manufacture and sale of ice by appellants was an established business so that proof of the amount lost on account of the delay. . . might be made with reasonable certainty," "the anticipated profits of the new business are too remote, speculative, and uncertain to support a judgment for their loss." It quoted an earlier decision in which another court had said that "he who is prevented from embarking in [*sic* -- must mean 'on'] a new business can recover no profits, because there are no provable data of past business from which the fact that anticipated profits would have been

realized can be legally deduced." *Central Coal & Coke Co. v. Hartman,* 111 Fed. 96, 99 (8th Cir. 1901). That quotation is taken to have made Arkansas a "new business" state, although the rest of the *Marvell* opinion indicates that the court was concerned that the anticipated profits of the *particular* new business at issue, rather than of every new business, were too speculative to support an award of damages. On its facts, moreover, *Marvell* was a classic *Hadley v. Baxendale* type of case -- in fact virtually a rerun of *Hadley,* except that the appellants alleged that they had notified the seller of the icemaking machinery of the damages that they would suffer if delivery was delayed, and the seller had agreed to be liable for those damages. The decision is puzzling in light of that allegation; it is doubly puzzling because, assuming that by the time of the trial the ice factory was up and running, it should not have been difficult to compute the damages that the appellants had lost by virtue of the five and a half month delay in placing the factory in operation. Presumably it would have had five and a half months of additional profits.

Marvell has never been overruled; and federal courts ordinarily take a nonoverruled decision of the highest court of the state whose law governs a controversy by virtue of the applicable choice of law rule to be conclusive on the law of the state. E.g., *Milwaukee Metropolitan Sewerage District v. Fidelity & Deposit Co.,* 56 F.3d 821, 823 (7th Cir. 1995); *C & B Sales & Service, Inc. v. McDonald,* 111 F.3d 27,29 n.1 (5th Cir. 1997); *New York Life Ins. Co. v. K N Energy, Inc.,* 80 F.3d 405,409 (10th Cir. 1996). But this is a matter of practice or presumption, not of rule. The rule is that in a

case in federal court in which state law provides the rule of decision, the federal court must predict how the state's highest court would decide the case, and decide it the same way. *Treco, Inc. v. Land of Lincoln Savings & Loan,* 749 F.2d 374, 377 (7th Cir. 1984); *New Hampshire Ins. Co. v. Vieira,* 930 F.2d 696, 701 (9th Cir. 1991); 19 Charles Alan Wright, Arthur R. Miller & Edward H. Cooper, *Federal Practice and Procedure* § 4507, pp. 126-50 (2d ed. 1996). Law, Holmes said, in a controversial definition that is, however, a pretty good summary of how courts apply the law of other jurisdictions, is just a prediction of what the courts of that jurisdiction would do with the case if they got their hands on it. Oliver Wendell Holmes, "The Path of the Law ," 10 *Harv. L. Rev.* 457, 461 (1897). Since state courts like federal courts do occasionally overrule their decisions, there will be occasional, though rare, instances in which the best prediction of what the state's highest court will do is that it will *not* follow its previous decision. See, e.g., *Burgess v. Lowery,* 201 F.3d 942, 948 (7th Cir. 2000); *Treco, Inc. v. Land of Lincoln Savings & Loan, supra,* 749 F.2d at 377; *Lightning Lube, Inc. v. Witco Corp.*, 4 F.3d 1153,1176 (3d Cir. 1993); 19 Wright, Miller & Cooper, *supra,* § 4507, pp. 141-49.

That is the best prediction in this case. *Marvell* was decided more than three quarters of a century ago, and the "new business" rule which it has been thought to have announced has not been mentioned in a published Arkansas case since. The opinion doesn't make a lot of sense on its facts, as we have seen, and the Eighth Circuit case on which it relied has long been superseded in that circuit. See, e.g., *Central Telecom,munications, Inc. v. TCI Cablevision, Inc.,*

800 F.2d 711, 727-28 (8th Cir. 1986). The Arkansas cases decided since *Marvell* that deal with damages issues exhibit a liberal approach to the estimation of damages that is inconsistent with a flat rule denying damages for lost profits to all businesses that are not well established. *Jim Halsey Co. v. Bonar,* 683 S.W.2d 898, 902-03 (Ark. 1985); *Tremco, Inc. v. Valley Aluminum Products Corp.,* 831 S.W.2d 156, 158 (Ark. App. 1992); *Ozark Gas Transmission Systems v. Barclay,* 662 S.W.2d 188, 192 (Ark. App. 1983); J.W. Looney, "The 'New Business Rule' and Breach of Contract Claims for Lost Profits: Playing Mindgames with Arkansas Law," 1997 *Ark. L. Notes* 43, 46-47. The *Ozark* decision, for example, allowed an orchard farmer to recover for the damages to a *new* orchard. The "new business" rule has, moreover, been abandoned in most states that once followed it, e.g., *Beverly Hills Concepts, Inc. v. Schatz & Schatz, Ribicoff & Kotkin,* 717 A.2d 724, 733-35 (Conn. 1998); *AGF, Inc. v. Great Lakes Heat Treating Co.,* 555 N.E.2d 634, 637-39 (Ohio 1990); *No Ka Oi Corp. v. National 60 Minute Tune, Inc.,* 863 P.2d 79, 81-82 (Wash. App. 1993); *Orchid Software, Inc. v. Prentice-Hall, Inc.,* 804 S.W.2d 208, 210-11 (Tex. App. 1991); *Beck v. Clarkson,* 387 S.E.2d 681, 683-84 (S.C. App. 1989); see also *McNamara v. Wilmington Mall Realty Corp,* 466 S.E.2d 324, 330 (N.C. App. 1996); *International Telepassport Corp. v. USFI, Inc.,* 89 F.3d 82, 85-86 (2d Cir. 1996) (per curiam) (New York law); *Restatement, supra,* § 352, comment b, and it seems to retain little vitality even in states like Virginia, which purport to employ the hard-core per se approach. See *Commercial Business Systems, Inc. v. Bellsouth Services, Inc.,* 453 S.E.2d 261, 268-69 (Va. 1995);

see generally *Eljer Mfg., Inc. v. Kowin Development Corp.*, 14 F.3d 1250, 1256 (7th Cir. 1994).

Western tries to distinguish *Ozark* by pointing to the fact that the plaintiff there was an established orchard farmer, albeit the particular orchard represented a new venture for him. This effort to distinguish that case brings into view the primary objection to the "new business" rule, an objection of such force as to explain its decline and make it unlikely that Arkansas would follow it if the occasion for its supreme court to choose arose. The objection has to do with the difference between *rule* and *standard* as methods of legal governance. A rule singles out one or a few facts and makes it or them conclusive of legal liability; a standard permits consideration of all or at least most facts that are relevant to the standard's rationale. A speed limit is a rule; negligence is a standard. Rules have the advantage of being definite and of limiting factual inquiry but the disadvantage of being inflexible, even arbitrary, and thus overinclusive, or of being underinclusive and thus opening up loopholes (or of being *both* over and underinclusive!). Standards are flexible, but vague and open-ended; they make business planning difficult, invite the sometimes unpredictable exercise of judicial discretion, and are more costly to adjudicate -- and yet when based on lay intuition they may actually be more intelligible, and thus in a sense clearer and more precise, to the persons whose behavior they seek to guide than rules would be. No sensible person supposes that rules are always superior to standards, or vice versa, though some judges are drawn to the definiteness of rules and others to the flexibility of standards. But that is psychology; the important point is that some activities are

better governed by rules, others by standards. States that have rejected the "new business" rule are content to control the award of damages for lost profits by means of a standard -- damages may not be awarded on the basis of wild conjecture, they must be proved to a reasonable certainty, e.g., *Beverly Hills Concepts, Inc. v. Schatz & Schatz, Ribicoff & Kotkin, supra,* 717 A.2d at 733-34; *AGF, Inc. v. Great Lakes Heat Treating Co., supra,* 555 N .E.2d at 638-39, that is applicable to proof of damages generally. See, e.g., *Jones Motor Co. v. Holtkilmp, Liese, Beckemeier & Childress, P.C.,* 197 F.3d 1190, 1194-95 (7th Cir. 1999), and cases cited there; *Ashland Management Inc. v. Janien,* 624 N.E.2d 1007, 1010 (N.Y. 1993); *Restatement, supra,* § 352. The "new business" rule is an attempt now widely regarded as failed to control the award of such damages by means of a rule.

The rule doesn't work because it manages to be at once vague and arbitrary. One reason is that the facts that it makes determinative, "new," "business," and "profits," are not facts, but rather are the conclusions of a reasoning process that is based on the rationale for the rule and that as a result turns the rule into an implicit standard. What, for example, is a "new" business? What, for that matter, is a "business"? And are royalties what the rule means by "profits"? MindGames was formed more than a year before it signed the license agreement with Western, and it sold 30,000 games in the six months between the first sales and the signing of the contract. MindGames' only "business," moreover, was the licensing of intellectual property. An author who signs a contract with a publisher for the publication of his book would not ordinarily be regarded as being engaged in a "business," or his royalties

or advance described as "profits." He would be surprised to learn that if he sued for unpaid royalties he could not get them because his was a "new business." Suppose a first-time author sued a publisher for an accounting, and the only issue was how many copies the publisher had sold. Under the "new business" rule as construed by Western, the author could not recover his lost royalties even though there was no uncertainty about what he had lost. So construed and applied, the rule would have no relation to its rationale, which is to prevent the award of speculative damages.

Western goes even further, arguing that even if it, Western, a well-established firm, were the plaintiff, it could not recover its lost profits because the sale of "Clever Endeavor" was a new business. On this construal of the rule, "business" does not mean the enterprise; it means any business activity. So Western's sale of a new game is a new business, yet we know from the *Ozark* decision that an orchard farmer's operation of a new orchard is an old business.

The rule could be made sensible by appropriate definition of its terms, but we find it hard to see what would be gained, given the existence of the serviceable and familiar standard of excessive speculativeness. The rule may have made sense at one time; the reduction in decision costs and uncertainty brought about by avoiding a speculative mire may have swamped the increased social costs resulting from the systematically inadequate damages that a "new business" rule decrees. But today the courts have become sufficiently sophisticated in analyzing lost-earnings claims, and have accumulated sufficient precedent on the standard of undue

speculativeness in damages awards, to make the balance of costs and benefits tip against the rule. In any event we are far in this case, in logic as well as time, from the ice factory whose opening was delayed by the General Electric Company. We greatly doubt that there is a "new business" rule in the common law of Arkansas today, but if there is it surely does not extend so far beyond the facts of the only case in which the rule was ever invoked to justify its invocation here. There is no authority for, and no common sense appeal to, such an extension.

But that leaves us with the question of undue speculation in estimating damages. Abrogation of the "new business" rule does not produce a free-for-all. What makes MindGames' claim of lost royalties indeed dubious is not any "new business" rule but the fact that the success of a board game, like that of a book or movie, is so uncertain. Here newness enters into judicial consideration of the damages claim not as a rule but as a factor in applying the standard. Just as a start-up company should not be permitted to obtain pie-in-the-sky damages upon allegations that it was snuffed out before it could begin to operate (unlike the ice factory in *Marvell,* which did begin production, albeit a little later than planned), capitalizing fantasized earnings into a huge present value sought as damages, so a novice writer should not be permitted to obtain damages from his publisher on the premise that but for the latter's laxity he would have had a bestseller, when only a tiny fraction of new books achieve that success. Damages must be proved, and not just dreamed, though "some degree of speculation is permissible in computing damages, because reasonable doubts as to remedy ought to be resolved

against the wrongdoer." *Jones Motor Co. v. Holtkamp, Liese, Beckemeier & Childress, P.C., supra,* 197 F.3d at 1194; see *Restatement, supra,* § 352, comment a.

This is not to suggest that damages for lost earnings on intellectual property can never be recovered; that "entertainment damages" are not recoverable in breach of contract cases. That would just be a variant of the discredited "new business" rule. What is important is that Blackwell had no track record when he created "Clever Endeavor." He could not point to other games that he had invented and that had sold well. He was not in the position of the bestselling author who can prove from his past success that his new book, which the defendant failed to promote, would have been likely -- not certain, of course -- to have enjoyed a success comparable to that of the average of his previous books if only it had been promoted as promised. That would be like a case of a new business launched by an entrepreneur with a proven track record.

In the precontract sales period and the first year of the contract a total of 195,000 copies of "Clever Endeavor" were sold; then sales fizzled. The public is fickle. It is possible that if Western had marketed the game more vigorously, more would have been sold, but an equally if not more plausible possibility is that the reason that Western didn't market the game more vigorously was that it correctly sensed that demand had dried up.

Even if that alternative is rejected, we do not see how the number of copies that would have been sold but for the

alleged breach could be determined given the evidence presented in the summary judgment proceedings (a potentially important qualification, of course); and so MindGames' proof of damages is indeed excessively speculative. See, e.g., *Gentry v. Little Rock Road Machinery Co.*, 339 S.W.2d 101, 104 (Ark. 1960); *Hillside Enterprises v. Carlisle Corp.*, 69 F.3d 1410, 1414 (8th Cir. 1995); *K & R, Inc. v. Crete Storage Corp.*, 231 N.W.2d 110, 115 (Neb. 1975); see also *AGF, Inc. v. Great Lakes Heat Treating Co., supra,* 555 N.E.2d at 640. Those proceedings were completed with no evidence having been presented from which a rational trier of fact could conclude *on this record* that some specific quantity, or for that matter some broad but bounded range of alternative estimates, of copies of "Clever Endeavor" would have been sold had Western honored the contract. Mind Games obtained $600,000 in royalties on sales of 165,000 copies of the game, implying that Western would have had to sell more than 10 million copies to generate the $40 million in lost royalties that MindGames seeks to recover. Cf. *Boxhorn's Big Muskego Gun Club, Inc. v. Electrical Workers Local494,* 798 F.2d 1016, 1023 (7th Cir. 1986).

When the breach occurred, MindGames should have terminated the contract and sought distribution by other means. See Farnsworth, *supra,* § 12.12, pp. 806-08. The fact that it did not do so -- that so far as appears it has made no effort to market "Clever Endeavor" since the market for the game collapsed in 1991 -- is telling evidence of a lack of commercial promise unrelated to Western's conduct.

Although Western in its brief in this court spent most of its time misguidedly defending the "new business" rule, clinging to *Marvell* for dear life (a case seemingly on point, however vulnerable, is a security blanket that no lawyer feels comfortable without), it did argue that in any event MindGames' claim for lost royalties was too speculative to ground an award of damages for that loss. The argument was brief but not so brief as to fail to put MindGames on notice of a possible alternative ground for upholding the district court's judgment; we may of course affirm an award of summary judgment on any ground that has not been forfeited or waived in the district court. *United States v. Jackson,* 207 F.3d 910, 917 (7th Cir. 2000). MindGames did not respond to the argument in its reply brief. It pointed to no evidence from which lost royalties could be calculated to even a rough approximation. We find its silence eloquent and Western's argument compelling, and so the judgment in favor of Western is

AFFIRMED.

FAIRCHILD, *Circuit judge,* dissenting in part. I agree that (1) MindGames' claim for a renewal fee for the year following the initial term of the Licensing Agreement was properly dismissed, and (2) we are not bound by *Marvell Light & Ice Co. v. General Electric Co.,* 259 S.W. 741 (Ark. 1924) to affirm the dismissal of MindGames' claim for loss of royalties caused by breach of contract. I do, however, respectfully disagree with the conclusion that, as a matter of law, that claim is too speculative to support an award of damages.

This was never a claim in which MindGames sought to recover lost profits from the operation of a business. The damages sought would be measured by the royalties which Western would have been obliged to pay on sales which did not occur because of Western's alleged failure to perform its contract. Western's obligation to pay royalties arose from the sales of games manufactured, promoted and sold by it, and whether MindGames showed a profit, as well as MindGames' lack of history, was wholly irrelevant. The ultimate questions would be whether there was a breach by Western and whether the breach caused a loss of sales.

Sales did not meet expectations. In the period from March 30, 1990 to January 31,1991, 165,000 games were sold; in the year ending January 31, 1992, 58,113; in the year ending January 31, 1993, 26,394; and in the year after the initial term, 7,438. The sales in the initial term totaled approximately $4,000,000 and royalties $600,000. Soon after January 31, 1993, Western was sufficiently interested in continuing as licensee to agree to pay a minimum royalty of $27,500 for the coming year. MindGames' complaint alleged that a substantial number of games produced by Western failed to meet quality standards; Western failed to promote and make reasonable efforts to sell; and its efforts did not meet standards under the agreement or those recognized in the industry. It is MindGames' position that these failures caused loss of sales.

Western's motion for partial summary judgment was premised on the new business rule which Western perceived as announced in *Marvell,* and the district court granted the motion on that basis. If, as we all agree, *Marvell* does not

control this case, then the applicable Arkansas doctrine is that MindGames is entitled to recover any royalties on sales which MindGames can prove to a reasonable certainty would have been made had Western carried out the contract. The rule that damages which are uncertain cannot be recovered does not apply to uncertainty as to the value of the benefits to be derived, but to uncertainty as to whether any benefit would be derived at all. *Jim Halsey Co., Inc. v. Bonar,* 284 Ark. 461, 467-68 (Ark. 1985); *Crow v. Russell,* 226 Ark. 121, 123 (Ark. 1956).

In my opinion we cannot say on this record, as a matter of law, that MindGames can not prove to a reasonable certainty that Western's failures to perform, if proved, caused a loss of sales.

I would not hold that MindGames has waived or forfeited its opportunity to produce evidence of damages. It is true that in responding to Western's motion for partial summary judgment MindGames did not provide evidentiary material tending to show the breaches by Western nor that such breaches caused a loss of sales. This should not be deemed a waiver or forfeiture of an opportunity to do so because of Western's complete reliance in its motion on the new business rule and *Marvell,* which, if applied, would prevent proof of breach and causation of loss. Western's motion did not reach the issue of breach, and establishing damages would require MindGames to prove that the breach occurred and caused loss of sales. Although Western, in its memorandum in support of its motion did include a section making the point that the success of a new product in the

entertainment industry is especially difficult to predict, it used that point to support an argument that the new business rule was particularly appropriate in this case, and that the Arkansas Supreme Court would be unlikely to retreat from the new business rule under circumstances like these. Western did not squarely assert, as an alternative ground, that MindGames could not prove to a reasonable certainty that any breach by Western caused loss of sales. Rather, Western urged that the district court should strictly apply the new business rule.

In this court, Western again relied on *Marvell* and the new business rule, also arguing, as it had in the district court, that this type of case, involving a new product in the entertainment industry, is not one where the Arkansas Supreme Court would retreat from its application of the new business rule. Although at pages 30-32 of its brief it asserted the inherently speculative nature of a claim for lost profits in the entertainment industry, and cited cases, it failed squarely to assert, as an alternative ground, that its alleged failures to perform, if proved, could not have been proved to a reasonable certainty to have caused lost sales. On page 5 of its reply brief, MindGames referred to pages 29-32 of Western's brief, and challenged as contrary to Arkansas law "non-Arkansas cases [cited by Western] in arguing that businesses in the entertainment industry are barred *per se* from claimmg lost profits." Again I do not think it is appropriate to rely on waiver or forfeiture.

I would remand for further proceedings on this part of MindGames' complaint.

A true Copy:

Teste:

_____

Clerk of the United States Court of Appeals for the Seventh Circuit

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF WISCONSIN

WESTERN PUBLISHING COMPANY, INC.

Plaintiff,

vs. **Case Number: 94-C-552**

MINDGAMES, INC.,

Defendant.

Consolidated With

MINDGAMES, INC.,

Plaintiff,

vs. **Case Number: 94-C-998**

WESTERN PUBLISHING COMPANY, INC.,

Defendant.

DECISION AND ORDER

Before the Court is Western Publishing Company, Inc.'s ("Western") Motion for Partial Summary Judgment and Motion to Strike. For the following reasons, the Court holds that MindGames, Inc. ("MindGames") is hereby prevented from recovering damages for expected lost profits from a licensing agreement with Western under Arkansas law. Therefore, Western's Motion for Partial Summary Judgment is GRANTED and Motion to Strike is DENIED.

I. BACKGROUND

This litigation results from a disputed licensing agreement between MindGames, the licensor, and Western the licensee. MindGames seeks lost profits and compensatory damages from an alleged breach of the licensing agreement. Western now files a motion for partial summary judgment, seeking to prevent MindGames, as a matter of law, from recovering lost anticipated profits stemming from the alleged breach.

In March 1988, G. Lawrence Blackwell, III formed MindGames to promote and sell a new board game he had created called *Clever Endeavor. Mr.* Blackwell believed that *Clever Endeavor* would reach the popularity achieved by games such as *Pictionary and Trivial Pursuit.* After selling 30,000 copies of the game in 1989, Mr. Blackwell decided to enter into a licensing agreement with Western and Games Gang, Inc. ("Games Gang"). Under the terms of the agreement, Western and Games Gang planned to market, manufacture, promote, distribute and sell *Clever Endeavor.* Blackwell and MindGames would receive royalties on the number of games sold. Net sales for *Clever Endeavor in*

1990, the first year of the agreement, totalled 165,000, but fell off dramatically starting in 1991, until late 1993 when Western drastically reduced prices to eliminate excess stock of the game.

In 1994, MindGames brought suit for breach of the marketing agreement. Among other damages, MindGames seeks $40 million as lost profits that they believe the game would have realized had it been marketed correctly. Western now brings a motion for partial summary judgment on the issue of the lost profits. Western claims that the "New Business Rule," which prevents new and unestablished business ventures from collecting lost profits as damages in breach of contract or tort cases, guides this case as a matter of law, and mandates partial summary judgment in Western's favor. The Court now addresses Western's motion.[1]

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[1]Western has also filed a Motion to Strike the affidavit of Mr. Blackwell. Motions to strike are generally disfavored and information "will not be stricken unless it is evident that it has no bearing upon of the subject matter of the litigation." Securities and Exchange Commission v. Jos. Schlitz Brewing Co., 452 F. Supp. 824, 833,(E.D. Wis. 1978) (quoting Van Dyke Ford, Inc. v. Ford Motor Co., 399 F. Supp. 277 (E.D. Wis. 1975). Both parties have submitted information that is irrelevant on the legal issue before the Court: whether Arkansas law allows a new business to recover lost profits. Nonetheless, the Court having considered the affidavit of Mr. Blackwell, concludes for the reasons that follow that there are no disputed issues of material fact precluding awarding partial summary judgment to Western. Therefore, Western's Motion to Strike is **DENIED.**

II. LEGAL STANDARD

Summary judgment is no longer disfavored under the Federal Rules of Civil Procedure. See Celotex Corp. v. Catrett, 477 U.S. 317, 327 (1986) ("Summary judgment procedure is properly regarded as an integral part of the Federal Rules as a whole which are designed to 'secure the just, speedy and inexpensive determination of every action.'"). Federal Rule of Civil Procedure 56 requires a District Court to grant summary judgment "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(c). The mere existence of some factual dispute does not defeat a summary judgment motion; "the requirement is that there is a genuine issue of material fact." Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 248 (1986). For a dispute to be genuine, the evidence must be such that a "reasonable jury could return a verdict for the nonmoving party." Id. For the fact to be material, it must relate to a disputed matter that "might affect the outcome of the suit." Id.

The party moving for summary judgment bears the initial burden of showing that there are no material facts in dispute and that judgment should be entered in its favor. Hannon v. Turnage, 892 F.2d 653, 656 (7th Cir. 1990), cert. denied, 498 U.S. 821 (1990). A defendant moving for summary judgment may satisfy this initial burden by pointing to a plaintiff's failure to introduce sufficient evidence to support each essential element of the cause of action alleged. Anderson, 477 U.S. at 256; Celotex, 477 U.S. at 323-24. A

party opposing a properly supported summary judgment motion "may not rest upon mere allegations or denials," but rather must introduce affidavits or other evidence to "set forth specific facts showing that there is a genuine issue for trial." Fed. R. Civ. P. 56(e). See also Celotex, 477 U.S. at 322-23; Becker v. Tenenbaum-Hill Assoc., Inc., 914 F.2d 107, 110 (7th Cir. 1990). "If the adverse party does not so respond, summary judgment, if appropriate, shall be entered against the adverse party." Fed. R. Civ. P. 56(e).

In evaluating a motion for summary judgment, the Court must draw all inferences in a light most favorable to the non-moving party. Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574 (1986); Johnson v. Pelker, 891 F.2d 136, 138 (7th Cir. 1989). "However, we are not required to draw every conceivable inference from the record -- only those inferences that are reasonable." Bank Leumi Le-Israel, B.M. v. Lee, 928 F.2d 232, 236 (7th Cir. 1991) (citations omitted.)

III. ANALYSIS

A. The New Business Rule as Valid Law

In general, when any business tries to recover lost profits in a breach of contract action, it must prove that the profits would have occurred with "reasonable certainty" but for the actions of the party in breach. American Fidelity Fire Ins. Co. v. Kennedy Bros. Constr., Inc., 282 Ark. 545, 670 S.W.2d 798 (1984). When the company seeking damages is a new business, the burden of proof to establish "reasonable certainty" rises considerably. Some states completely prevent the recovery of any profits in a new business situation. This

prevention of recovery is referred to as the "New Business Rule," currently under dispute in the litigation before this Court.

The Eighth Circuit in Hillside Enterprises v. Carlisle Corp., 69 F.3d 1410 (8th Cir. 1995) (wine marketer sued disposable wine glass manufacturer for lost profits after manufacturer failed to ship specifically ordered number of glasses that marketer was to use in "wine-in-a-glass" venture) cites Ferrell Constr. Co. v. Russell Creek Coal Co., 645 P.2d 1005, 1009-10 (Okla. 1982) as an example that would satisfy this newer, higher burden of proof of lost profits. The Hillside court notes that the plaintiffs, in Ferrell were coal mining for a finite amount of steel when the breach of contract occurred. The amount of steel limited the profits that the plaintiff should have achieved, making the profits easily discernible and relatively certain. Hillside, 69 F.3d at 1414. Had such a definite order not been present, the plaintiff would not have satisfied its requisite burden of certainty.

Many states adhere to the above-described approach when determining whether to award lost profits for a new business. States in the Eighth Circuit, like Missouri (Handi Caddy, Inc. v. American Home Products Corp., 557 F.2d 136 (8th Cir. 1977)) and Iowa (Harsha v. State Sav. Bank, 346 N.W.2d 791 (Iowa 1984)) recognize that the enforcement of any type of "New Business Rule" lies in the uncertainty of proving profits. With ample evidence of certainty, those states will allow evidence of lost profits to factor into the determination of damages awards. Minnesota takes the most liberal approach to this concept. Minnesota law (La Societe Immobiliere v. Minneapolis Community Dev. Agency, 827 F.

Supp. 1431 (D.Minn. 1993) *rev'd on other grounds,* 44 F.3d 629 (8th Cir. 1994) and Leoni v. Bemis Co., 255 N.W.2d 824 (Minn. 1977)) emphasizes the lack of a *per se* rule in favor of preventing new businesses from collecting anticipated profits. The state willingly allows evidence of lost profits into court, and, according to Olson v. Rugloski, 277 N.W.2d 385, 388 (Minn. 1979), requires the plaintiff to prove only reasonable certainty, not absolute certainty, to recover lost profits. Other states, such as Ohio and Michigan, have abandoned the *per se* "New Business Rule" in favor of a slightly more liberal approach that allows the party seeking damages an opportunity to prove those damages. See Fera v. Village Plaza, Inc., 242 N.W.2d 372, 376 (Mich. 1976); AGF, Inc. v. Great Lake Heat Treating Co., 555 N.E.2d 634, 638-39 (Ohio 1990).

At the minimum, even states that have now abandoned a *per se* approach to the "New Business Rule" will require plaintiffs to prove, with the certainty seen in Hillside, that the profits in question would have occurred before they may recover. The higher burden of proof is considered a rigorous standard of certainty to meet. The Southern District of New York, a state that allows recovery for lost profits in certain cases, gives the most succinct reason for making recovery of lost profits of a new business venture extremely difficult to achieve. The New York court, stated:

> The prospective profits of a new business or enterprise are regarded as being too remote, contingent, and speculative to meet the legal standard of reasonable certainty in determining the elements of recoverable damages in an action for breach of contract or for a tort.

International Minerals and Resources, Inc. v. Pappas, 761 F. Supp. 1068, 1079 (S.D.N.Y. 1991) (quoting 36 N.Y.Jur.2d Damages § 110, at 193-94 (1984)), *vacated on other grounds*, --- F.3d ---, 1996 WL 506612 (2d Cir. Sept. 6, 1996).

In addition, this dispute arises out of the entertainment industry which further reduces the certainty of MindGames' profits, making it more difficult to justify an award of lost profits. Even in states which do not adopt the strict application of the "New Business Rule," such as New York, the influence of the entertainment industry does not go unnoticed. In Kenford Co. v. County of Erie, 493 N.E.2d 234, 236 (N.Y. 1986), the New York Court of Appeals, in upholding the Superior Court's remittitur of a jury award for lost profits, noted the difficulty in establishing reasonable certainty for a new business. The court also found that the nature of the dispute (claiming lost profits from what would have been a sports stadium) increased uncertainty, stating, "New York has long recognized the inherent uncertainties of predicting profits in the entertainment field in general." Id. The Second Circuit echoed the Kenford decision in Proteus Books Ltd. v. Cherry Lane Music, 873 F.2d 502 (2d Cir. 1989). The court quoted Kenford's assessment of the entertainment industry's effect on the uncertainty of profits in its case dealing with a book publishing dispute. Proteus, 873 F.2d at 510.

As noted earlier, some states still accept the "New Business Rule" as *a per se* measure to completely prevent the recovery of any profits. See Stuart Park Associates Limited Partnership v. Ameritech Pension Trust, 51 F.3d 1319, 1328 (7th Cir. 1995) (Illinois law); Springwill Dispensers, Inc. v.

Hall.China Co., 419 S.E.2d 112 (Ga. App. 1992) (Georgia law); Murray v. Hadid, 385 S.E.2d 898, 905 (Va. 1989) (Virginia law). Arkansas, the state whose law guides this case, still views the "New Business Rule" as a *per se* rule prohibiting the recovery of lost profits in a new business venture.

Based on its limited amount of case law, the state of Arkansas follows the "New Business Rule" strictly in preventing any recovery of lost profits. In Marvell Light & Ice Co. v. General Electric Co., 162 Ark. 467, 259 S.W. 741 (1924), the only Arkansas case addressing the "New Business Rule," General Electric brought suit against Marvell Light to recover over $700 for machinery sold to Marvell Light for assistance in constructing an ice plant. Marvell Light counterclaimed for profits lost during General Electric's delayed delivery of machinery. In sustaining General Electric's demurrer to the counterclaim, the Supreme Court of Arkansas stated, "anticipated profits of the new business are too remote, speculative, and uncertain to support a judgment for their loss." Marvell Light, 259 SW. at 741.

MindGames claims that Marvell Light is no longer good law because it is "a seventy-two-year-old procrustean case" that has not been followed since its outcome, and it has been eroded away by more recent Arkansas cases. Although Marvell Light has not been cited, it has not been overruled, and therefore, it remains good law. In addition, none of the cases cited by MindGames for its legal proposition involve a new business. According to MindGames, 555 Incorporated v. Leming, 45 S.W.2d 18 (Ark. 1932); Jim Halsey Co. v. Bonar, 683 S.W.2d 898 (Ark, 1985); Tremco, Inc. v. Valley

Aluminum Products Corp., 831 S.W.2d 156 (Ark. App. 1992); and Union National Bank of Little Rock v. Mosbacher, 933 F.2d 1440 (8th Cir. 1991), cert. denied, 502 U.S. 1031 (1992), all supposedly erode the Arkansas Supreme Court's decision in Marvell Light. However, the parties seeking damages in these above-cited cases are established businesses, and consequently, their influence in the case herein is minimal. For example, in Union National Bank, the Eighth Circuit acknowledged that courts can award lost profits to businesses that prove those profits would have occurred with "reasonable certainty." Union National Bank, 933 F.2d at 1444. However, Union National Bank involved a furniture company that had been in existence for over forty years at the time it filed suit. Certainly, the business in Union National Bank did not qualify as a "new business" subject to Marvell Light's rule.

Also, MindGames relies on 1 Dunn, Recovery of Damages for Lost Profits § 4.1 (4th ed. 1992) to argue that the "New Business Rule" is an "older rule" followed by a "diminishing number of states." (MindGames' Response at p. 8.) First, and foremost, a treatise, regardless of its persuasive value, is not law. Second, MindGames neglects to point out that Dunn expressly includes Arkansas as one of those "diminishing number" of states that still follow the "New Business Rule" and gives no indication that Arkansas will overrule their current position.

Decisions from the Seventh Circuit and Eastern District of Wisconsin detail how federal courts interpret state law and give further reasons for following Marvell Light. The Eastern District of Wisconsin, adhering to the seminal

decision of Erie R.R. v. Tompkins, 304 U.S. 64 (1938), states that. "[f]ederal courts in diversity actions are bound to accept the interpretations of state law by the state's highest court .... The Court's responsibility is to apply the relevant state law as it presently exists." Jaeger v. Raymark Industries, Inc., 610 F. Supp. 784, 787-88 (E.D. Wis. 1985); Midwest Helicopters Airways v. Sikorsky Aircraft, 849 F. Supp. 666, 668 (E.D. Wis.), *aff'd,* 42 F.3d 1391 (7th Cir. 1994). The Seventh Circuit reinforces this approach regarding the interpretation of state law by federal courts. See Kutsugeras v. Avco Corp., 973 F.2d 1341 (7th Cir. 1992) ("Under principles of Erie v. Tompkins [*Citation omitted*], a federal court must apply the state law as declared by the highest state court or otherwise by the intermediate appellate court of the state."). These principles clearly apply in this case where the parties brought suit solely pursuant to diversity jurisdiction. See Shaw v. Republic Drill Corp., 810 F.2d 149,.150 (7th Cir. 1987) ("[W]e have already indicated our unwillingness to speculate on any trends in state law. *[Citation omitted.]* This policy applies special force to a plaintiff in a diversity case who has chosen to litigate his state law claim in federal court."); Afram Export Corp. v. Metallurgiki Halyps, S.A., 772 F.2d 1358, 1370 (7th Cir. 1985) ("A party who wants a court to adopt an innovative rule of state law should litigate in state court. Federal judges are disinclined to make bold departures in areas of law that we have no responsibility for developing.").

MindGames suggests that we use the Third Circuit as a guide for how federal courts change state law. In In re Merritt Logan, Inc., 901 F.2d 349 (3d Cir. 1990), the Third Circuit considered then-current New Jersey law which

embraced *a per se* application of the "New Business Rule." The Court, in recognizing the recent trend of New Jersey cases and cases nationwide, overruled the old "New Business Rule" cases in favor of the modern approach to damages involving lost profits. Merritt Logan, 901 F.2d at 357.

However, two distinctions prevent the Court in the case herein from adopting the Third Circuit's approach to deciding the case. First, in Merritt Logan, New Jersey case law preceding the Merritt Logan decision had indicated an inkling to abandon the "New Business Rule." No recent Arkansas case has shown that Arkansas appears willing to discard the "New Business Rule." As previously discussed, all cases cited by MindGames involved established business gaining an opportunity to show damages. Second, the approach of the circuit courts vary in this field. The Third Circuit interpreted its role as "predict[ing] whether the New Jersey Supreme Court would follow the rule against giving a new business damages for lost profits if it were now presented with that issue in the context of this case." Id. Clearly, the Seventh Circuit does not use the same standard as the Third Circuit when interpreting state law. For the Court to do so in this case would result in a direct contradiction of controlling earlier cited Seventh Circuit law. In sum, the Court has no responsibility to expand or alter existing Arkansas state law.

Finally, in reference to the validity of the "New Business Rule," the Court notes a Seventh Circuit case cited by Western. In arguing against MindGames proposition that this Court follow others across the country and abandon the *per se* application of the "New Business Rule," Western points out the Seventh Circuit's attitude towards such judicial

activity: "Given that Florida law governs this case, the authorities from other jurisdictions cited and argued by the parties [citations omitted] are only indirectly relevant. Gust K. Newberg Constr. Co. v. E.H. Crump & Co., 818 F.2d 1363, 1368 n.7 (7th Cir. 1987). In conclusion, the decision in Marvell Light is the controlling law of Arkansas. For the case herein, Arkansas law governs, and Arkansas law accepts the "New Business Rule" *per se*.

B. Application of the "New Business Rule"

The Texas Court of Civil Appeals best describes what most courts look for as they distinguish between new and established businesses for purposes of applying the "New Business Rule." In Atomic Fuel Extraction Corp. v Slick, 386 S.W.2d 1-80, 189 (Tex.Ct.Civ.App. 1964), the court stated:

> An established business should be one that is in actual operation long enough to give it permanency and recognition. It should be one that has earned a profit which can be reasonably ascertained and approximated. . . . Proof of an operation of a business at a loss fails to meet the test.

The courts have used the duration of the business' existence and its record of profits to determine whether a corporation qualifies as a new business. See Delahanty v. First Pennsylvania Bank N.A., 464 A.2d 1243, 1261 (Pa. Super. Ct. 1983) (seven months of operation not enough of a record of profitability to sustain an award of damages for anticipated profits; the court hints that two years may have been enough);

McBrayer v. Teckla, Inc., 496 F. 2d 1 22 (5th Cir. 1974) (plaintiff not entitled to lost profits because he was only in operation for a little over nine months and had not achieved a profit in that time); Proteus Books, Ltd. v. Cherry Lane Music, 873 F.2d 502 (2d Cir. 1989) (company with two years of existence, but poor sales, still qualifies as a new business).

It appears that *Clever Endeavor* and MindGames both satisfy the two elements of the new business test. The licensing agreement that brought the parties in this suit together consummated in March of 1990. MindGames had been incorporated since March of 1988, and did not produce a product until 1989. The company decided to market the game (its sole product) in the spring of 1989, but it did not reach the market until September, 1989. (See Blackwell Dep. at pp. 24, 107, 168-69.) All told, *Clever Endeavor* was on the market for approximately six months before the licensing agreement began. Additionally, in those six months, MindGames did not turn a profit. (See Western's Brief in Support of its Motion for Partial Summary Judgment, Exh. B and G.) Because *Clever Endeavor* did not have an established record of profitability, and because it had such a short lifespan, it qualifies as a new business, subject to the application of the "New Business Rule."

C. MindGames' Arguments Against Using the "New Business Rule"

MindGames opposes the use of this rule because it believes *Clever Endeavor* had an established track record; because neither Western nor Games Gang was a new business; and because MindGames' royalties were pure profits.

MindGames' first argument has already been dismissed; as to the other two, they shall likewise be rejected. Whether Western or Games Gang qualifies as a new business is irrelevant in this case. When a court looks to award lost profits in any situation, it measures lost profits by the past profits of the party seeking the damages -- not the party that caused the damages. Every case cited by the Court supports this proposition. Similarly, in determining whether to apply the "New Business Rule," the court looks to the party seeking the profits to see whether or not that party is a new business. As the Supreme Court of Arkansas noted in Marvell Light, "He *who is prevented from embarking in a new business* can recover no profits because there are no provable data of past business from which the fact that anticipated profits would have been realized can be legally deduced." Marvell Light 259 S.W. at 741 (quoting Central Coal and Coke Co. v. Hartman, 111 Fed. 96, 49 C.C.A. 244) (emphasis added).

As a side note, the "New Business Rule" applies to new products sold by an existing business. See Stuart Park Associates, Ltd. v. Ameritech Pension Trust, 846 F. Supp. 701 (N.D. Ill. 1994), *aff'd,* 51 F.3d 1319, 1328 (7th Cir. 1995) (Illinois law - "New Business Rule" state) (plaintiffs success with other apartment buildings did not yield damages for lost profits in a similar, but different real estate venture); Pennsylvania State Shopping Plazas, Inc. v. Olive 120 S.E.2d 372 (Va. 1961) (plaintiff had operated 14 service stations successfully, but opening a new one still constituted a new business). *Clever Endeavor* remained on the market for only six months prior to the licensing agreement, clearly making it a new product. Therefore, even if the Court would accept

MindGames' suggestion that the Court should measure the "New Business Rule" by Western and Games Gang, established businesses, the rule still applies in this case.

MindGames attempts to use a technicality to avoid the application of the "New Business Rule" to this case. The "New Business Rule" applies to parties seeking lost profits; MindGames claims it seeks lost *royalties,* rather than profits, and therefore, the "New Business Rule" does not apply to this case.

The Court sees this attempt by MindGames as a futile effort to avoid Arkansas case law. In MindGames' complaint, the company states that "[t]he breaches of the agreement by Western and Games Gang, Ltd. have caused substantial damages, both present and future, to MindGames, including loss of profits and interference with MindGames' business relations." (MindGames Complaint at ¶8.) In addition, in a February, 1996 letter from MindGames' counsel to Western's counsel, MindGames classified the damages sought as "lost future profits." (See Western's Reply Brief, Exh. D.) It appears that MindGames chose to make the distinction between profits and royalties only after realizing the strength of Western's "New Business Rule" defense.

Also, MindGames uses Corbin's definition of profits to attempt to prove the difference between profits and royalties. See 5 Corbin On Contracts § 1022, at 135-36 (1964) (profit is the full value of performance minus the cost of performance; MindGames argues that no cost of performance was taken away from the royalties, meaning it could not have been profits). In doing so, MindGames

neglects Black's Law Dictionary's definition of royalties: a "share of product or **profit** reserved by owner for permitting another to use the property." Black's Law Dictionary 1330 (6th ed. 1990).

Moreover, MindGames neglects persuasive case law in this area. Generally, the courts have treated lost royalties in the same manner as lost profits in damages claims. See Oral-X Corp. v. Farnam Companies, Inc., 931 F.2d 667, 670 (10th Cir. 1991) (reversing district court's refusal to award damages for royalties as lost profits); In re Mid-America Corp., 159 B.R. 48, 55 (M.D. Fla. 1993) (the speculative nature of determining lost profits precluded franchisor's recovery of damages for lost royalties).

In sum, the Court sees the difference between profits and royalties as a *de minimis* one. The important issue is that MindGames seeks the recovery of a form of compensation; for these purposes, no difference exists between royalties and profits.

D. Whether Granting Partial Summary Judgment to Western is Appropriate.

Whether the court decides to grant summary judgment on this matter depends on whether any genuine issue of material fact related to the controlling, substantive law of the case remains to be disputed at trial. Kendrick v. East Delavan Baptist Church, 886 F. Supp. 1465 (E.D. Wis. 1994) (Warren, J.). If the court determines that either the movant established uncontroverted facts entitling it to summary judgment or demonstrated that the non-moving party has failed to make a sufficient showing on an essential element of the

case, then a grant of summary judgment is proper. Donovan v. City of Milwaukee, 845 F. Supp. 1312 (E.D. Wis. 1992) (Reynolds, J.), *aff'd,* 17 F.3d 944 (7th Cir. 1994).

Because the Court accepts current Arkansas law as controlling, no issue of material fact regarding lost anticipated profits remains. In addition, the Court finds that MindGames has failed to meet its obligation to make a sufficient showing on any essential element relating to the attempt to seek lost profits. The law of Marvell Light remains valid, and under Seventh Circuit precedent, the Court must follow it. Therefore, summary judgment as a matter of law is proper in this case.

Furthermore, granting summary judgment on the issue of the "New Business Rule" is not uncommon and lends support to the Court's decision. Although most "New Business Rule" cases arise out of a court of appeals overturning the trial court's award for lost anticipated profits, occasionally the matter is dismissed at summary judgment. In Rich v. Eastman Kodak, 583 F.2d 435, 437 (8th Cir. 1978), the Eighth Circuit upheld the Eastern District of Missouri's grant of summary judgment in a case where lost profits could not be claimed because the party seeking the recovery had no history of profitability by which to measure anticipated profits. The Eighth Circuit also upheld the Southern District of Iowa's grant of summary judgment in United States v. Dura-Lux International Corp., 529 F.2d 659 (8th Cir. 1976). In Dura-Lux, the defendant counterclaimed against the United States for lost profits. The court granted the United States' motion for summary judgment on the basis that the profits were unduly speculative since the business was "an untried

enterprise with no history of profitability." Dura-Lux, 529 F.2d at 663.

Finally, a summary judgment dismissal of a claim for anticipated profits is not unheard of within this jurisdiction. In Autotrol Corp. v. Continental Water Sys. Corp., 694 F. Supp. 603 (E.D. Wis. 1988) (Gordon, J.), a case strikingly similar to the case at hand, Judge Gordon granted summary judgment in a case applying Texas law. Texas law strictly embraces the "New Business Rule" (See Atomic Fuel Extraction, *supra),* and Judge Gordon agreed with the defendants' claim in Autotrol that the plaintiff could not recover profits as a matter of law. Autotrol, 694 F. Supp. at 605. Because Arkansas strictly follows the "New Business Rule," no reason exists why the Court cannot follow the precedent of this District and grant summary judgment in favor of Western.

IV. CONCLUSION

Based on the foregoing discussion, the Court holds that the application of Arkansas law to the undisputed facts of this case establishes that MindGames cannot, as a matter of law, recover its lost profits from anticipated sales of *Clever Endeavor.*

THEREFORE, IT IS HEREBY ORDERED:

1 . Western Publishing Company, Inc.'s Motion for Partial Summary Judgment is GRANTED.

2. Western Publishing Company, Inc.'s Motion to Strike is DENIED.

3. The Court has scheduled a conference call for 9:30 a.m., Monday, October 28, 1996 to address further scheduling of this case. Counsel for Western Publishing Company, Inc. is to initiate the call.

SO ORDERED this 11th day of October, 1996, at Milwaukee, Wisconsin.

Robert W. Warren
United States District Judge

In the

United States Court of Appeals

For the Seventh Circuit

August 22, 2000

Before

Hon. Thomas E. Fairchild, *Circuit Judge*
Hon. Richard A. Posner, *Circuit Judge*
Hon. Diane P. Wood, *Circuit Judge*

No. 98-1879

MINDGAMES, INC.

Plaintiff-Appellant,

v.

WESTERN PUBLISHING COMPANY, INC.,

Defendant-Appellee.

Appeal from the United States District Court
for the Eastern District of Wisconsin.
Nos. 94 C 552, 94 C 998 -- **Lynn S. Adelman**, *Judge*

ORDER

On July 6, 2000, plaintiff-appellant filed a petition for rehearing and petition for rehearing *en banc* and on August 8, 2000 defendant-appellee filed an answer with appendix. A majority of the judges on the original panel have voted to deny the petition. None of the active judges has requested a vote on the petition for rehearing *en banc*. The petition is therefore DENIED.

Hon. Thomas E. Fairchild voted to grant the petition for rehearing

United States District Court

Eastern District of Wisconsin

JUDGMENT IN A CIVIL CASE

WESTERN PUBLISHING COMPANY, INC.

Plaintiff,

vs. Case Number: 94-C-552

MINDGAMES, INC.,

Defendant.

MINDGAMES, INC.,

Plaintiff,

vs. Case Number: 94-C-998

WESTERN PUBLISHING COMPANY, INC.,

Defendant.

Decision by the Court. This action came to trial or hearing before the Court. The issues have been tried or heard and a decision has been rendered.

IT IS ORDERED AND ADJUDGED that all claims of the plaintiff, MindGames, Inc., in Case No. 94-C-998 other than those dismissed pursuant to the summary judgment decisions and orders entered herein on October 11, 1996 and February 25, 1998 are hereby dismissed without prejudice and without costs.

March 20, 1998

SOFRON B. NEDILSKY
Clerk

United States District Court

Eastern District of Wisconsin

WESTERN PUBLISHING COMPANY, INC.

Plaintiff,

vs. Case Number: 94-C-552

MINDGAMES, INC.,

Defendant.

MINDGAMES, INC.,

Plaintiff,

vs. Case Number: 94-C-998

WESTERN PUBLISHING COMPANY, INC.,

Defendant.

WESTERN PUBLISHING COMPANY, INC.'S MEMORANDUM IN SUPPORT OF ITS MOTION FOR PARTIAL SUMMARY JUDGMENT

I. INTRODUCTION

The driving force behind this dispute between MindGames, Inc. ("MindGames") and Western Publishing

Company, Inc. ("Western") is MindGames' belief that Western's alleged breach of the parties' license agreement prevented MindGames' new adult board game called *"Clever Endeavor"* from achieving the same success as two of the most successful adult board games of all time, *Pictionary* and *Trivial Pursuit*. Rather than attributing *Clever Endeavor's* limited success to the erratic whims of the consumer and the game's own shortcomings, MindGames is determined to place the blame on Western -- the exclusive licensee of *Clever Endeavor* for almost its entire shelf life. In so doing, MindGames seeks over $40 million dollars in damages for profits it allegedly lost due to Western's breach of the license agreement. However, MindGames cannot, as a matter of law, recover its alleged lost profits because Arkansas still applies the "New Business Rule," which *prevents* the recovery of *any* lost profits for a new product, such as *Clever Endeavor*. The inherent difficulties of predicting the success of a product in the entertainment and leisure industry further dictate the strict application of the New Business Rule.

Moreover, MindGames' failure to show any history of profitability before its license agreement with Western, provides a second reason that MindGames is legally precluded from recovering any anticipated lost profits. Consequently, Western respectfully requests that this Court grant it partial summary judgment on the portion of MindGames' claim which seeks damages for its alleged lost profits.

II. WESTERN'S PROPOSED FINDINGS OF FACT

A. The Parties.

1. Western Publishing Company, Inc. ("Western") is a corporation organized and existing under the laws of the State of Wisconsin, with its principal place of business located at 1220 Mound Avenue, Racine, Wisconsin.

2. MindGames, Inc. ("MindGames") is a corporation organized and existing under the laws of the State of Arkansas, with its principal place of business located at 2720 West 28th Street, Pine Bluff, Arkansas.

B. Jurisdiction and Venue.

3. Western and MindGames are citizens of different states and the matter in controversy involves a sum in excess of $50,000, exclusive of interest and costs. Accordingly, this Court has jurisdiction over this action pursuant to 28 U.S.C. §1332(a).

4. Western has its principal place of business in the Eastern District of Wisconsin, and the causes of action asserted in this lawsuit arose in this District. Venue is therefore proper in this District pursuant to 28 U.S.C. §1391(a).

C. The Development of *Clever Endeavor*.

5. In March 1988, Larry Blackwell ("Blackwell") formed MindGames for the sole purpose of manufacturing, marketing and selling a new adult board game he invented called *Clever Endeavor*. (See p. 24 of the

Deposition of Larry Blackwell ("Blackwell Dep."). Copies of the relevant pages of Mr. Blackwell's deposition transcript are attached hereto as Group Exhibit A). *Clever Endeavor* was MindGames' first and only product. (Blackwell Dep. p. 34).

6. At the time Blackwell formed MindGames, he had no prior experience in the game industry or the adult game market in particular. (Blackwell Dep. pp. 46, 84). Nevertheless, Blackwell believed that *Clever Endeavor* would appeal to the same market and achieve the same success as the two most successful adult board games of their time, *Pictionary* and *Trivial Pursuit*. (Blackwell Dep. pp. 79-81). Blackwell formed this belief without having any discussions with anyone in the game industry regarding what features made *Trivial Pursuit* and *Pictionary* successful games. (Blackwell Dep. p. 82).

7. Prior to its initial distribution of the game in September 1989, MindGames conducted some minimal test marketing of *Clever Endeavor,* such as playing the prototype of *Clever Endeavor* with focus play groups out of Blackwell's parents' and friends' homes. (Blackwell Dep. pp. 160-165).

8. In the spring of 1989, Blackwell decided to publish *Clever Endeavor*. (Blackwell Dep. p. 107). From the spring of 1989 through the end of the year, MindGames marketed the game itself by promoting it at certain events and through radio advertising and cooperative advertising with retailers. (Blackwell Dep. p. 172). MindGames, however, did not use any type of television advertising to

promote *Clever Endeavor* because Blackwell did not believe that the cost for such advertising justified the expense. (Blackwell Dep. pp. 174-175).

9. During 1989, MindGames sold approximately 30,000 games, but failed to achieve a profit for that year. Blackwell Dep. pp. 169; See, the 1989 Income Statement for MindGames, a copy of which is attached hereto as Exhibit B).

D. The License Agreement.

10. In December 1989, Blackwell met with two representatives from a game company called Games Gang, Inc. ("Games Gang"), which was the current distributor of *Pictionary*. (Blackwell Dep. pp. 192-193). These discussions culminated on March 30, 1990 when MindGames, as Licensor, entered into an exclusive license agreement with Western and Games Gang, as Licensees, for the manufacture, marketing, promotion, sale and distribution of the *Clever Endeavor* game (the "License"). (A copy of the License is attached hereto as Exhibit C).

11. The License is governed in all respects by the laws of the State of Arkansas. (Exhibit C at ¶ 20).

12. The License, among other things, required Western and Games Gang to pay MindGames royalties based on the number of games sold and to provide a minimum amount of advertising support to *Clever Endeavor*. (Exhibit C at ¶¶ 4, 6).

13. The term of the original License extended through January 31, 1993. (Exhibit C at ¶ 2). The License

provided that, if the Licensees were not in breach, the License would continue until January 31, 1994 in the event that the Licensees paid MindGames at $1.5 million (whether earned or unearned in royalties during the term of the License) prior to January 31, 1993. (Exhibit C at ¶ 2). For any renewal term beginning on or after January 31, 1994, the Licensees were required to pay MindGames $300,000, less royalties earned between January 31, 1993 and January 31, 1994. (Exhibit C at ¶ 2).

14. On March 13, 1991, the parties amended the License by allowing the Licensees to reduce the percentage of gross sales to be utilized for advertising and promotion in order to "keep the cost of the game down." A copy of the March 13, 1991 letter agreement amending the License (the "1991 Amendment") is attached hereto as Exhibit D.

15. With the written consent of MindGames, Western assumed the duties and obligations of the other licensee, Games Gang, under the License, pursuant to a sublicense agreement dated February 3, 1992. Western served as the exclusive licensee of *Clever Endeavor* through January 31, 1994.

16. The net sales of *Clever Endeavor* during the original term of the License were as follows:

Fiscal Year	*Clever Endeavor* Units Sold
FY 1990	165,000
FY 1991	58,113
FY 1992	26,394
FY 1993	7,438

III. NATURE OF THE DISPUTE

MindGames alleges that *Clever Endeavor* was not successful because Western breached the License by, inter alia, 1) failing to pay MindGames the minimum royalties necessary to renew the License, 2) failing to properly manufacture and distribute *Clever Endeavor,* 3) failing to "diligently and actively promote and make every reasonable effort to market and sell *Clever Endeavor*" and 4) failing to provide the amount of advertising support required under the License. (See, MindGames' Complaint, a copy of which is attached hereto as Exhibit E). As a result of the alleged breach of the License by Western, MindGames seeks damages against Western in excess of $40 million dollars. (See the April 25, 1995 letter from MindGames' attorney, a copy of which is attached hereto as Exhibit F). MindGames bases almost the entire amount of its damage claim on the profits it allegedly lost due to Western's alleged breach of the License.[1]

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[1]MindGames also seeks $1.2 million for royalties allegedly owed to renew the License for the period of February 1, 1993 through January 31,

(continued...)

IV. ARGUMENT

A. The Standard For Granting Summary Judgment.

Rule 56(c) of the Federal Rules of Civil Procedure deems summary judgment appropriate "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." Kendrick v. East Delavan Baptist Church, 886 F. Supp. 1465, 1471 (E.D. Wisc. 1995) (Warren, J.) citing Celotex Corp. v. Catrett, 477 U.S. 317, 322, 106.S. Ct. 2505, 2510 (1986); see, Donovan v. City of Milwaukee, 845 F. Supp. 1312, 1313 (E.D. Wisc. 1992) (Reynolds, J.). The presence of a genuine issue of material fact is to be determined by the substantive law controlling that case or issue. Kendrick, 886 F. Supp. at 1471. Although some facts may be in dispute, entry of summary judgment is in order if the movant either establishes uncontroverted facts entitling it to summary judgment or demonstrates that the non-moving party has failed to make a sufficient showing on an essential element of its case with respect to which it will bear the burden of proof at trial. Donovan, 845 F. Supp. at 1314.

The application of Arkansas law to the undisputed facts of this case establishes that MindGames cannot, as a matter of law, recover its lost profits. Therefore, Western

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[1](...continued)
1994 and for the period of February 1, 1994 through January 31, 1995.

respectfully requests that this Court grant it partial summary judgment, and find that MindGames is precluded from seeking damages for its alleged lost profits.

B. The "New Business Rule" Prevents MindGames From Recovering Any Lost Profits.

Western emphatically denies that it breached any of the terms of the License. However, even assuming *arguendo* that MindGames could demonstrate that Western or Games Gang breached any provision of the License, MindGames is legally precluded from recovering its lost profits.

1. *Arkansas follows the "New Business Rule."*

As a new business, MindGames is barred under Arkansas law from introducing any evidence regarding its lost profits. Arkansas follows the "New Business Rule," which holds that a new or unestablished business is precluded, as a matter of law, from recovering lost profits. Marvell Light & Ice Co. v. General Electric Co., 162 Ark. 467, 259 S.W. 741 (1924). The Arkansas Supreme Court reasoned that '[t]he anticipated profits of a new business are too remote, speculative and uncertain to support a judgment for their loss." 259 S.W. at 741. Accord Central Coal & Coke Co. v. Hartman. I 1 1 F. 96, 98 (8th Cir. 1901).

Although the Supreme Court of Arkansas has not addressed this issue since it decided Marvell Light in 1924, there is no reason to believe that the Arkansas Supreme Court's has changed its position on the recovery of lost profits by a new business. Despite exhaustive research,

Western has failed to discover a single Arkansas case considering evidence of lost products for a new business after the Marvell Light decision This dearth of authority supports the proposition that Arkansas courts continue to adhere firmly to Marvell Light.

Nor is there any reason to believe that the Arkansas courts would deviate from the Marvel Light decision now. The rationale supporting the Arkansas Supreme Court's ruling continues to remain as persuasive today as it did in 1924. As the Fourth Circuit explained in Coastland Corp, v. Third National Mortgage, Co., 611 F.2d 969 (4th Cir. 1979), the New Business Rule provides a "safeguard" against an unsubstantiated award of damages for lost profits:

> "If an established business, with an established earning capacity, is interrupted and there is no other practical way to estimate the damages thereby caused, evidence of the prior and subsequent record of the business is admissible to permit an intelligent and probable estimate of damages... But where a ***new*** business or enterprise is involved, the rule is not applicable for the reason that such a business is a ***speculative venture,*** the successful operating of which depends upon future bargains, the status of the market, and too many other contingencies to furnish a safeguard in fixing the measure of damages."

(Emphasis added). Coastland Corp., 611 F.2d at 977. In fact, the New Business Rule actually serves to encourage new businesses. Fear of exposure to a damages claim arising from an inventor's own expectation of his product's potential for success would chill companies like Western from seeking to promote new products.

It is therefore not surprising that a number of courts have recently affirmed the New Business Rule, and refused to consider evidence of lost profits for a new business. See, e.g. Stuart Park Associates Limited Partnership v. Ameritech Pension Trust, 51 F.3d 1319, 1328 (7th Cir. 1995) (Illinois law); Hillside Enterprises v. Carlisle Corp., 69 F.3d 1410, 1413-1415 (8th Cir. 1995) (Oklahoma law); Springwill Dispensers, Inc. v. Hall China Company, 204 Ga. App. 245, 419 S.E.2d 112 (1992) (Georgia law); Center Ridge Ganley, Inc. v. Stinn, 71 Ohio App. 3d 514,594 N.E.2d 1064, 1070 (1991) (Ohio law); International Minerals and Resources, Inc. v. Pappas, 761 F. Supp. 1069, 1079 (S.D.N.Y. 1991) (New York law); Murray, etc., et al. v. Hadid, et al., 238 Va. 722, 385 S.E.2d 898, 905 (1989) (Virginia Law); In re Phoenix Restoration Specialists, Inc., 14 B.R. 115, 123-24 (Bkrptcy. Mass. 1981) (Massachusetts law).

2. Clever Endeavor was a new venture or a new business.

Although MindGames incorporated in March 1988, MindGames was clearly a new business in March of 1990 when it executed the License and joined forces with Western and Games Gang. Consequently, MindGames, as

a "new business," is subject to the repercussions of the New Business Rule.

Blackwell asserts that he envisioned *Clever Endeavor* when he incorporated MindGames in March 1988; however, MindGames did not decide to even market *Clever Endeavor* until the spring of 1989, and it did not manufacture and distribute the first wave of *Clever Endeavor* games until September 1989. (See Blackwell Dep. pp. 24, 107, 168-169). Four months after MindGames began to distribute *Clever Endeavor,* Blackwell met with representatives of Games Gang to discuss a joint venture. (See, Blackwell Dep. pp. 192-193). These discussions culminated in the execution of the License in March 1990. In total, MindGames marketed and sold *Clever Endeavor* itself for less than a year before it joined forces with Western and Games Gang, and it failed to achieve ***any*** profit during that period of time. (See Exhibit B; see also MindGames' 1988 income statement, a copy of which is attached hereto as Exhibit G).

Under these circumstances, MindGames is clearly a "new" business as a matter of law. See, e.g. McBrayer v. Teckla, Inc., 496 F.2d 122 (5th Cir. 1974) (plaintiff not entitled to lost profits in his breach of contract claim because he was only in operation for 9 and a half months prior to the contract and failed to achieve a profit during that time); Delhanty, et al. v. First Pennsylvania Bank, N.A., 318 Pa. Super. 90, 464 A.2d 1243 (1983) (court held that plaintiff company's anticipated profits were too speculative to sustain an award of damages because plaintiff

had only been in operation for seven months and had no record of profitability).

MindGames may argue that it was an "established" business at the time it executed the License, and, therefore, it is not subject to the New Business Rule. However, such an assertion would be in vain.

MindGames had barely introduced *Clever Endeavor* to the public before it executed the License and permitted Western and Games Gang to exclusively manufacture, market, sell and distribute *Clever Endeavor*. Moreover, MindGames operated ***only*** at a loss prior to joining forces with Western and Games Gang. .(See, Exhibits B and G). These traits are not characteristic of an "established" business.

> "An established business should be one that is in actual operation long enough to give it permanency and recognition. It should be one that has earned a profit which can reasonably be ascertained and approximated ... Proof of an operation of a business at a loss fails to meet this test."

McBrayer, 496 F.2d at 128, quoting Atomic Fuel Extraction Corporation v. Slick, 386 S.W.2d 180, 189 (Tex. Ct. Civ. App. 1964).

Additionally, Blackwell's own admissions contradict any claim that MindGames, whose sole product was *Clever Endeavor*, was not a "new" business. In his September 12, 1990 letter to Games Gang, Blackwell relayed his concerns about the proposed television advertising campaign for

Clever Endeavor. Significantly, one of the reasons he rejected the proposed commercial had to do with his classification of *Clever Endeavor* as a new product:

> "Furthermore, ***new*** products don't benefit from short duration commercials in the same way as older, more established products do. ***New*** products need longer duration commercials in order to gain the same consumer response."

(Emphasis added) (A copy of Blackwell's September 12, 1990 letter to Games Gang is attached hereto as Exhibit H). Clearly, Blackwell himself still considered *Clever Endeavor* to be a new product six months ***after*** the parties executed the License. Consequently, MindGames will not be able to avoid the New Business Rule's preclusive effect on its attempt to recover its alleged lost profits.

3. The success of a new product in the entertainment industry is especially difficult to predict.

Even if the Court were to question whether the Arkansas Supreme Court would retreat from its across the board application of the New Business Rule, there can be no doubt that such a retreat would not be warranted here. It is particularly appropriate to apply this rule in the entertainment/consumer product industry where the chances of success are next to impossible to predict because an entertainment product, such as an adult board game, is subject to the most subjective and unpredictable critic - the public. See, Proteus Books Ltd. v. Cherry Lane Music Co,

873 F.2d 502, 510 (2nd Cir. 1989) (affirming district court's decision to vacate jury's damages award because, inter alia, inherent uncertainties of predicting profits in the entertainment industry made prospective sales of book publisher difficult, if not impossible, to calculate); Kenford Co. v. County of Erie, 67 N.Y.2d 257, 493 N.E.2d 234, 236 (1986) (court found plaintiff's evidence of prospective profits of new stadium insufficient to support any recovery for lost profits).

Among numerous other factors, the success of a product in the entertainment industry is contingent on many subjective factors including:

- the play value or enjoyment one obtains from the product;
- the economy at the time the product is introduced to the market;
- the number of similar products in the market;
- the cost of the product itself.

Mr. Blackwell himself has conceded that the game industry is especially susceptible to the unique tastes of the average consumer and unanticipated oscillations in the marketplace. In his October 18, 1990 letter to Greta Perry of the Gazette Newspapers in New York, Blackwell attached Ms. Perry's recent article on the game industry and praised Ms. Perry's "keen analysis" of what makes a game successful. (A copy of Blackwell's October 18, 1990 letter and the attached article by Ms. Perry is attached hereto as Exhibit I). In Ms. Perry's article, one industry

commentator noted: "For every 1000 games that get invented, five make it to the shelf and maybe one of two get a ***second*** year." (Emphasis added) (See, Exhibit I). Later, in his application to Harvard Business School in 1994, Blackwell himself acknowledged the difficulty of marketing a successful game in the entertainment industry when he admitted that:

> "[building a successful game company and licensing their first product] is a popular and powerful dream, but unfortunately, too few actually succeed. When one recalls the more publicized failures of product introductions by established corporations, I [Blackwell] believe [MindGames'] accomplishment becomes more substantial. The experience proved my [Blackwell's] business and leadership skills in a hostile and unforgiving market." (See, p. 7 of Mr. Blackwell's application to Harvard Business School, a copy of which is attached hereto as Exhibit J.)

Despite these long odds, Blackwell thought that *Clever Endeavor* would be the "next *Trivial Pursuit* or *Pictionary*, (See, Exhibit F), and he was apparently disappointed that *Clever Endeavor* fell short of his lofty expectations.[2] However, *Clever Endeavor's* limited success

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[2]Mr. Blackwell's credibility on the issue of *Clever Endeavor's*

(continued...)

can be attributed to many factors independent of the alleged manufacturing or advertising problems, including the following potential causes:

1. *Clever Endeavor* was one of the more expensive adult games in the market (Blackwell Dep. p. 98);

2. There were other similar adult board games on the market, including *Anybody's Guess,* which were similar to *Clever Endeavor* (Blackwell Dep. pp. 423-433);

3. Despite Western's advice, Blackwell rejected television advertising in favor of radio advertising (Blackwell Dep.

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[2](...continued)
purported lack of success is questionable at best. Contrary to the allegations in MindGames' complaint, Mr. Blackwell repeatedly touted the "success" of Clever Endeavor. For example, in his applications to Harvard and Stanford business schools, Blackwell claims that *Clever Endeavor* was the "most successful, independently published game in the [adult game] industry for the four years following its introduction" and the "most successful game introduced by an independent game publisher in the past five years." (See, Exhibit J at p. 7; see also Mr. Blackwell's application to Stanford Business School, a copy of which is attached hereto as Exhibit K, and Mr. Blackwell's June 6, 1994 letter to the Harvard Business School, a copy of which is attached hereto as Exhibit L.) Moreover, in his September 7, 1990 letter to Games Gang, Blackwell states: "Thanks for your terrific support. You're the reason for Clever Endeavor's **success**. (Emphasis added) (A copy of the September 7, 1990 letter is attached hereto as Exhibit M.)

pp. 361, 369-370, 378, 386-392; see also Blackwell's September 12, 1990 letter to Dave Gillies at Games Gang regarding the effectiveness of radio advertising, a copy of which was previously attached hereto as Exhibit H);

4. *Clever Endeavor's* first full year in the marketplace, 1990, was a "rotten" year for the industry as a whole (See, Blackwell's January 9, 1991 letter to Mary Mellor at Games Gang, a copy of which is attached hereto as Exhibit N); and

5. The play value of the game itself, which may not have appealed to consumers to the degree Mr. Blackwell hoped.

The aforementioned facts are just a few of the many reasons that *Clever Endeavor* did not become the next *Trivial Pursuit* or *Pictionary*. It is the nature of the entertainment industry itself, as well as common sense, which necessarily dictate that one cannot point to a single factor which caused *Clever Endeavor* to fail to achieve the success MindGames now claims it expected.

The Eight Circuit Court's opinion in Hillside Enterprises illustrates the rationale and application of the New Business Rule in the entertainment/consumer product industry. In Hillside Enterprises, a wine marketer

("Hillside") sued a disposable wine manufacturer ("Carlisle") for breach of contract after the manufacturer failed to properly manufacture and ship the required number of Hillside's new product -- disposable plastic wine glasses with fliptop lids. Hillside alleged that it could not fill its first, and only, large order for 30,000 glasses, and that its "wine-in-a-glass" venture lost substantial profits and ceased operations as a result of Carlisle's failure to adequately manufacture the new product.

At trial, Hillside attempted to introduce evidence of its future sales from wine glasses which had not yet been ordered. The district court, however, refused to admit this evidence because it was too speculative, and Hillside appealed. On appeal, the Eight Circuit Court affirmed the district court's ruling, and expressly noted that lost profits are highly speculative and are generally not allowed as damages where a new business or product are at issue. Hillside Enterprises, 69 F.3d at 1414. Moreover, the court found that Hillside's product could have failed for reasons independent of the problems with the glasses, such as the cost of the product or consumers' failure to find the convenience of packaged wine more important than the price and quality of the wine. Id. For these reasons, the appellate court upheld the district court's decision to *only* allow evidence of lost profits from Hillside's one confirmed order for 30,000 glasses, which Hillside was unable to fulfill because of Carlisle's breach. Id.

Unlike the plaintiff in Hillside Enterprises, MindGames does not even allege that it lost profits as a result of Western's failure to fulfill a specific sales order or

that Western otherwise failed to pay MindGames its royalties for *Clever Endeavor* games previously sold by Western. Rather, MindGames only seeks profits from the uncertain or future sales of *Clever Endeavor* which it allegedly lost due to Western's breach of the License. Without being able to determine the "cause," MindGames cannot possibly be able to demonstrate the "effect" (*i.e.*, lost profits) with any reasonable certainty. Consequently, this Court should strictly apply the New Business Rule, as the Supreme Court of Arkansas did in Marvell Light & Ice Co., and prohibit MindGames' recovery of all its alleged lost profits as a matter of law.[3]

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[3]As a result of the unpredictable nature of the entertainment industry, it is not surprising that other parties similarly situated to MindGames have also been unable to recover the alleged lost profits of their new businesses. See, *e.g.*, Proteus Books Ltd. v. Cherry Lane Music Co., supra; National Controls v. National Semiconductor, 833 F. 2d 491 (3rd Cir. 1987) (buyer of microprocessor units failed to sustain burden of proving under Pennsylvania law that seller's breaches were proximate cause of buyer's alleged loss of profits on sale of telephones to third party, and, therefore, buyer not entitled to damages for lost profits); Handi Caddy, Inc. v. American Home Products Corp., 557 F.2d 136 (8th Cir. 1977) (8th Circuit Court reduced jury's damages award for lost profits because evidence in action to recover for breach of contract to advertise new product on pizza packages failed to support recovery of lost profits awarded by jury.); Murray, etc. et. al v. Hadid, et. al., supra (affirming trial court's decision to set aside jury's award of lost profits because evidence of new enterprise's lost profits depended upon too many contingencies to safeguard an estimate of damages); Kenford Co., Inc. v. County of Erie, supra.

4. MindGames has no history of past profits.

Even if the Court were to reject a strict application of the New Business Rule, this Court should still grant Western's motion for partial summary judgment because MindGames has no history of past profits.

In addition to the inherent difficulties of predicting the success of a new entertainment product, MindGames faces the additional burden of demonstrating its alleged lost profits without any prior history of profitability. It is undisputed that MindGames will not be able to introduce evidence of its profits prior to the alleged breach of the License committed by Western because MindGames failed to achieve any profit in 1988 or 1989. (See, Exhibits B and G). Without any evidence of past profits, anticipated profits often cannot be recovered regardless of whether the damaged party was a new business. See, Rich v. Eastman Kodak Company, 583 F.2d 435, 437 (8th Cir. 1978) (plaintiff company unable to recover its anticipated profits because it was not making a profit before problems developed with the product); Empire Shoe Company v. Nico Industries, Inc., 197 Ga. App. 411, 414, 398 S.E.2d 440, 443 (1990) (granting defendant summary judgment on the issue of lost profits because plaintiff could not produce any evidence regarding past net profits); see also Keener v. Sizzler Family Steak Houses, 597 F.2d 453, 459 (5th Cir. 1979). Consequently, without such evidence of past profits, MindGames will lack a reliable basis to demonstrate its alleged lost profits with any reasonable certainty.

V. CONCLUSION

For all the aforementioned reasons, Western respectfully requests that this Court grant its motion for partial summary judgment and find that MindGames cannot recover its alleged lost profits as a matter of law.

Dated: May 17, 1996

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United States District Court
Eastern District of Wisconsin

WESTERN PUBLISHING COMPANY, INC.

Plaintiff,

vs. Case Number: 94-C-552

MINDGAMES, INC.,

Defendant.

MINDGAMES, INC.,

Plaintiff,

vs. Case Number: 94-C-998

WESTERN PUBLISHING COMPANY, INC.,

Defendant.

WESTERN PUBLISHING COMPANY, INC.'S REPLY BRIEF IN SUPPORT OF ITS MOTION FOR PARTIAL SUMMARY JUDGMENT

Dated: August 8, 1996

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INTRODUCTION

The response of MindGames, Inc. ("MindGames") to the motion for partial summary judgment filed by Western Publishing Company, Inc. ("Western")[1], is legally

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[1]Subsequent to the filing of this Motion for Partial Summary Judgment

(continued...)

and factually deficient MindGames fails to invoke a single case decided under Arkansas law which even criticizes -- much less rejects or overrules -- *Marvell Light & Ice Co. v. General Electric Co.*, 259 S.W. 741 (Ark. 1924). Unable to argue that Arkansas law no longer employs the New Business Rule, MindGames is left to contend that this Court should modify Arkansas law by refusing to follow the *Marvell Light* decision. Instead, MindGames asks this Court to follow the trend in certain other jurisdictions to allow a new business to introduce evidence of its alleged lost profits. This argument contravenes the Seventh Circuit requirement that federal courts in diversity cases follow state law as it currently exists, rather than modifying state law, or predicting a change.

Implicitly recognizing the weakness of its argument, MindGames claims that even if the Court finds that the New Business Rule is viable, the Rule does not apply here because the licensors are not a new business. However, MindGames -- the party seeking lost profits -- is a new business, a fact that MindGames only halfheartedly challenges. Equally untenable is MindGames' contention that the New Business Rule does not apply because MindGames seeks lost "royalties," not lost "profits." The

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[1](...continued)
Western's corporate name has changed from Western Publishing Company, Inc. to Golden Books Publishing Company, Inc. However, to avoid unnecessary confusion, Plaintiff will continue to refer to itself as Western for purposes of this motion.

case law unequivocally establishes that lost royalties are a form of lost profits.

MindGames' response is equally deficient in its failure to meet its burden to come forward with affirmative evidence to rebut the facts Western offers in support of its motion. Even if this Court were to consider the conclusory and self-serving affidavit submitted by G. Lawrence Blackwell III (MindGames' principal), there are no disputed issues of material fact. The evidence Western submitted remains unrebutted. Controlling Arkansas law squarely supports Western's motion. Therefore, this Court should grant Western's motion for partial summary judgment and bar MindGames from seeking to recover any lost profits.

ARGUMENT

A. MindGames Has Failed To Meet Its Burden To Oppose Western's Motion.

At the outset, it is important to note one of the overriding defects in MindGames' response – its failure to meet its burden to come forward with affirmative evidence to counter Western's motion. This Court has repeatedly explained the burden of proof imposed on a party opposing summary judgment:

> The moving party has the initial burden of demonstrating that it is entitled to summary judgment as a matter of law. *[Citations omitted)*. Once this burden is met, the non-moving party must "go beyond the pleadings" and designate specific facts to support or defend each element of the cause

> of action, showing that there is a genuine issue for trial. *[Citations omitted].* Neither party may rest on mere allegations or denials in the pleadings, *[citations omitted,* and both parties must produce proper documentary evidence to support their contention. *[Citations omitted].*

Lisbon Square v. United States, 856 F. Supp. 482, 488 (E.D. Wis. 1994); *accord Criticare Systems, Inc. v. Nellcor Inc.,* 856 F. Supp. 495, 503 (E.D. Wis. 1994); *Flavel v. Svedala Industries, Inc., 868* F. Supp. 1422, 1456 (E.D. Wis. 1994).

Despite these admonitions, MindGames fails to submit any documentary evidence to support its contentions. Instead, MindGames relies solely on the conclusory statements in the Affidavit of G. Lawrence Blackwell III (the "Blackwell Affidavit").[2] This is clearly insufficient. "Self-serving affidavits without factual support will not defeat a motion for summary judgment *[citation omitted].* [A] plaintiff's speculation is not a sufficient defense to a summary judgment motion." *Slowiak v. Land O'Lakes, Inc.,* 987 F.2d 1293 (7th Cir. 1993) (affirming summary judgment dismissing the plaintiff's antitrust claim because the record showed that the plaintiff failed to show injury required for standing.)

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[2]Simultaneously herewith, Western has filed a motion to strike the Blackwell Affidavit

B. MindGames Cannot Refute That *Marvell Light* Is The Controlling Precedent Under Arkansas Law.

The Arkansas supreme court decision in *Marvell Light & Ice Co. v. General Electric Co.*, 259 S.W. 741 (Ark. 1924), supplies the legal basis for Western's motion for partial summary judgment to preclude MindGames from introducing evidence of lost profits. As Western explained in its opening brief, *Marvell Light* established Arkansas as a jurisdiction that followed the New Business Rule.

MindGames' response tacitly concedes that *Marvell Light* remains the controlling authority under Arkansas law. MindGames fails to cite a single decision under Arkansas law that criticizes or overrules the *Marvell Light* opinion. Instead, MindGames argues that this Court should decline to follow *Marvell Light* because, at age 72, the decision is "procrustean," "outdated" and no longer followed in a majority of jurisdictions, making it unlikely that an Arkansas court would apply the New Business Rule today. (MindGames' Br. at 13.) This argument is not only unfounded, it is contrary to the well established rules of construction that courts are required to follow in diversity cases such as this.[3]

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[3]Not only does MindGames implicitly disparage all older decisions, it suggests that, contrary to *stare decisis*, courts revisit rules based on older case law.

1. No Arkansas decision represents a departure from *Marvell Light*.

It is curious that Dunn is one of the primary authorities upon which MindGames relies for the proposition that it is unlikely that an Arkansas court today would follow *Marvell Light* (MindGames' Br. at 8, 10.) Dunn expressly includes Arkansas as one of the "diminishing number of states that still follow the new-business rule." 1 Dunn, *Recovery of Damages for Lost Profits* (4th Ed.) Section 4.1 (1992) at 277-78. Dunn makes no suggestion that Arkansas will deviate from *Marvell Light* and reject the New Business Rule. *Id.*

Nevertheless, MindGames contends that because more recent Arkansas decisions suggest a more liberal standard for proof of damages, these cases portend a rejection of *Marvell Light*. (MindGames' Br. at 12.) None of the cases MindGames cites support this proposition. For example, MindGames concedes that *555 Incorporated v. Leming*, 45 S.W.2d 18 (Ark. 1932), did not involve a new business. (MindGames' Br. at 12.)[4] That case stands only for the black letter proposition that lost profits must be proved with reasonable certainty.

Similarly, each of the other Arkansas cases upon which MindGames relies involved an established business rather than a new business. In *Jim Halsey Co., Inc. v.*

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[4]Once again, it is curious that MindGames characters the 1924 *Marvell Light* decision as "procrustean" and outdated, but relies upon *555 Incorporated*, decided only eight years later.

Bonar, 683 S.W.2d 898 (Ark. 1985), the court confronted the issue of whether the plaintiff submitted adequate proof of the amount of lost profits, not whether lost profits were legally available. The plaintiff was established in his field, not in a new business. Therefore, the case cannot be read as a departure from *Marvell Light.* Similarly, both *Tremco, Inv. v. Valley Aluminum Products Corp.,* 831 S.W.2d 156 (Ark. App. 1992), and *Union National Bank of Little Rock v. Mosbacher,* 933 F.2d 1440 (8th Cir. 1991), considered whether an established business -- not a new business -- was entitled to recover lost profits.

MindGames also suggests that *First Service Corp. v. Schumacher,* 702 S.W.2d 412 (Ark. 1985), represents a departure from, the New Business Rule. This is a mischaracterization of the decision. The issue posed in *Schumacher* was whether plaintiff submitted sufficient evidence so that lost profits could be proved with reasonable certainty. The plaintiff was an established developer of residential subdivisions, not a new business. The contract between the parties specified that it was "to cover all remaining lots" in the subdivision. *Id.* at 414. At the time of the alleged breach, the plaintiff had already sold some of the homes in this development, and there were 134 remaining lots to be sold. Therefore, whether the New Business Rule precluded evidence of lost profits was not at issue. In holding that the plaintiff submitted adequate evidence of lost profits, the court found that the sale of other homes in the development provided a basis on which to calculate the potential profits on the sales of the remaining 134 lots. These facts are very different from the

situation presented here. *Clever Endeavor* is the first and only game MindGames offered. (Blackwell Dep. 34.)[5] Blackwell testified that in his opinion MindGames was "unique" and differentiated from all games on the market (Blackwell Dep. 93, 104.)

> 2. Under the controlling rules of construction, this Court is required to follow Arkansas law in its current state rather than to predict how Arkansas court might decide the issue in the future.

MindGames argues that, even if *Marvell Light* is still good law, this Court should nonetheless decline to follow it and instead follow the "majority" rule of allowing a new business to introduce evidence of lost profits. (MindGames' Br. at 10-11.) As both the Seventh Circuit and the Wisconsin District Court have recognized, *Erie R.R. v. Thompkins,* 304 U.S. 64, 58 S. Ct. 817 (1938), prohibits a federal court from modifying state law:

> Under principles of *Erie v. Thompk!ns [citation omitted],* a federal court must apply the state law as declared by the highest state court or otherwise by the intermediate appellate court of the state.

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[5]Relevant excerpts of the Blackwell Deposition are attached hereto as Group Exhibit A.

Kutsugeras v. Avco Corp., 973 F.2d 1341, 1346 (7th Cir. 1992); *accord, Jaeger v. Raymark Industries, Inc.*, 610 F. Supp. 784, 785-6 (E.D. Wisc. 1985) ("Federal courts in diversity actions are bound to accept the interpretations of state law by the state's highest court . . . . The Court's responsibility is to apply the relevant state law as it presently exists."); *Midwest Helicopters Airways v. Sikorsky Aircraft*, 849 F. Supp. 666, 668 (E.D. Wisc. 1994) (same).

These principles apply with even more force here because MindGames elected to file its complaint against Western in federal court under principles of diversity jurisdiction:

> In the context of pendent state law claims, we have already indicated out unwillingness to speculate on any trends in state law. *[Citation omitted.]* This policy applies special force to a plaintiff in a diversity case who has chosen to litigate his state law claim in federal court. We write only to emphasize our policy will continue to be one that requires plaintiffs desirous of succeeding on novel state law claims to present those claims initially in state court.

Shaw v. Republic Drill Corp., 810 F.2d 149,150 (7th Cir. 1987).

This Court has previously rejected a similar request to expand or reconsider state law in a diversity case. In *Afram Export Corp. v. Metallurgiki Halyps, S.A.*, 772 F.2d 1358, 1370 (7th Cir. 1985), the plaintiff sought to recover

as incidental damages interest it had to pay on a business loan. In affirming this Court's dismissal of this damage claim, the Seventh Circuit stated:

> We point out that [plaintiff] chose to bring this lawsuit in federal court (under diversity jurisdiction) rather than in a Wisconsin state court as it could have done. A party who wants a court to adopt an innovative rule of state law should litigate in state court. Federal judges are disinclined to make bold departures in areas of law that we have no responsibility for developing .... But certainly when a resident does invoke the diversity jurisdiction, and perhaps in any case, he cannot expect to receive a very sympathetic hearing for his argument that the federal court should adopt an innovative interpretation of state law.

The issue presented in *Afram* is precisely the issue presented here, and this Court should again refuse the plaintiffs invitation to change state law.

MindGames' reliance on *In re Merritt Logan, Inc.*, 901 F.2d 349 (3rd Cir. 1990), does not change this result. Not only is *Merritt Logan* factually distinguishable, the approach taken by the Third Circuit conflicts with how the Seventh Circuit applies state law in diversity cases. *Merritt Logan* confronted the question of whether a new business could recover lost profits under New Jersey law. The Third Circuit acknowledged that existing New Jersey case law

followed the New Business Rule, and that the New Jersey supreme court had not recently considered the issue. The Third Circuit interpreted its role as to "predict whether the New Jersey Supreme Court would follow the rule against giving a new business damages for lost profits if it were now presented with that issue in the context of this case." 901 F.2d at 357. Of course, this statement is directly contrary to the standard in the Seventh Circuit (See, pp. 5-6, *supra.)*

Moreover, even if the standard in the Seventh Circuit were not inconsistent with that taken *in Merritt Logan, Merritt Logan* would still not support MindGames' argument because there is a significant factual difference between that case and this one. In *Merritt Logan,* the Third Circuit noted that there was a recent decision by the New Jersey District court permitting a new business to recover lost profits. 901 F.2d at 357. There is no such decision by any court applying Arkansas law.

3. It Is Irrelevant That Jurisdictions Other than Arkansas Have Rejected The New Business Rule.

MindGames also argues that this Court should anticipate the Arkansas supreme court's rejection of the New Business Rule because other states have recently reconsidered the issue and abandoned the Rule. Once again, MindGames advances a rule of construction that the Seventh Circuit rejects:

> Given that Florida law governs this case, the authorities form other jurisdictions cited and

> argued by the parties [citations omitted] are only indirectly relevant.

Gust K. Newberg Construction Co. v. E.B. Crump & Co., 818 F.2d 1363, 1368 n .7 (7th Cir. 1987). Therefore, it is irrelevant that Michigan and Ohio may have abandoned the New Business Rule. (MindGames' Br. at 14-15.) Moreover, as Western pointed out in its initial brief, while some courts have rejected the New Business Rule, other jurisdictions have recently reaffirmed their commitment to follow the New Business Rule. (Western Br. at 9.)

C. MindGames Cannot Escape The New Business Rule By Arguing That It Does Not Apply To The Facts Presented Here.

MindGames tries to avoid the application of the New Business Rule by arguing that, even if this Court does follow *Marvell Light*, that case does not apply to the facts presented here. None of the distinctions MindGames tries to draw can save its claim for lost profits.

1. The Sale of Clever Endeavor Under The License Agreement Is A New Business.

First, MindGames contends that the New Business Rule does not apply because "Western and Games Gang are established businesses." (MindGames' Br. at 1-2, 9.) This argument misses the point. The New Business Rule examines whether the entity seeking to recover lost profits is a new business. (*See, e.g., Hillside Enterprises v. Carlisle Corp.*, 69 F.3d 1410 (8th Cir. 1995) (holding that the plaintiff could not recover lost profits allegedly caused

by the defendant's improper manufacture of its product, which the plaintiff claimed left him unable to fill future orders). Here, it is MindGames -- not Western or Games Gang -- which seeks to recover lost profits. Accordingly, the New Business Rule will apply if MindGames – or a venture comprised of MindGames, Western and Games Gang -- is a new business.

Whether viewed alone or in context with Western and Games Gang, MindGames must be classified as a new business. MindGames cannot and does not seriously challenge Western's claim that it is a new business, contesting neither the legal nor the factual support Western invokes. (See Western Br. at 9-12.) It is not surprising that MindGames chooses to ignore this evidence, since it difficult to imagine how MindGames could counter it. MindGames wisely does not even suggest that the sale of *Clever Endeavor* under the License Agreement is not a new business.

Instead, MindGames argues that *Clever Endeavor* was not a new product "in any relevant sense" because prior to the License Agreement, "it had been on the market for about a year and had enjoyed a high degree of success during the seven months that MindGames was shipping it." (MindGames' Br. at 3.) These statements are inaccurate:

- MindGames sold *Clever Endeavor* from September 1989 until early 1990. (Blackwell Dep. at 170.) This is at most a five month period.

- Prior to MindGames' commencement of sales in September 1989, MindGames projected it would sell 50,000 games in 1989. (Blackwell Dep. at 105.) In fact, MindGames sold only 30,000. (Blackwell Dep. 169.) It is not surprising that both Blackwell and MindGames' marketing manager Leslie Cox May characterized MindGames' sales prior to the License Agreement as only "satisfactory." (Blackwell Dep. 190; May Dep. 43.)[6]

- MindGames failed to earn any profit on *Clever Endeavor* sales prior to the commencement of the License Agreement. (App. Exhs. B and G.)

Even if these statements were true, they are irrelevant. As Western pointed out in its initial brief, courts have found businesses with an operating history of seven months or more to be subject to the New Business Rule. (Western Br. at 10.) MindGames does not address this case law.

2. The New Business Rule Applies To A New Product Sold By An Existing Business.

MindGames argues that, even if *Clever Endeavor* is deemed to be a new product, the New Business Rule still

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[6]The relevant excerpts of the deposition of Leslie Cox May ("May Dep.") are attached hereto as Exhibit B.

does not apply because it is inapplicable to new products sold by an existing business. Even if this Court were persuaded that MindGames had produced evidence that *Clever Endeavor* was sold by an existing business, none of the cases MindGames cites draw a distinction between a new business and a new product sold by an established business. In *John D. Copanos & Sons, Inc.* v. *McDade Rigging and Steel Erection Co.*, 403 A.2d 402 (Md. App. 1979), the court observed that the Maryland supreme court had ***not*** laid down a "flat rule" that a new business cannot recover lost profits. The court found it questionable whether the business at issue (the encapsulating process of penicillin) was even a new business, since the plaintiff had produced penicillin in other forms for years. In contrast here, not only has the Arkansas supreme court laid down a flat rule prohibiting a new business from recovering lost profits, neither MindGames nor Blackwell had any experience in the game industry prior to developing Cleaver Endeaver. (Blackwell Dep. 46.)

MindGames fares no better in relying on *Care Travel Co. v. Pan American World Airways, Inc.*, 944 F.2d 983 (2nd Cir. 1991. There, the plaintiff alleged that the defendant breached the agency agreement by allowing others to sell tickets for the London - Katachi, Pakistan - Bombay route. The court found that the travel agency at issue was not a new venture because (1) the principals had significant prior experience, not only with the travel industry in general, but with the route at issue in particular; (2) the plaintiff was selected to act as defendant's general service agent due to the prior experience of the principals;

and (3) the plaintiff submitted evidence of prior sales for the routes at issue. Here, in contrast, Blackwell had no prior experience in the game industry and *Clever Endeavor* was a new game.

Finally, MindGames invokes *Milex Products v. Alra Laboratories, Inc.*, 237 111. App. 3d 177, 603 N.E.2d 1226 (1992), where the court awarded lost profits to a new manufacturer of a fungible drug that its competitors had been manufacturing for years. The basis for this ruling was the fact that "while the product is a new one, the evidence showed it to have an established market." Id at 1237. A subsequent Seventh Circuit decision not only reaffirmed the New Business Rule under Illinois law, it distinguished Milex because "the plaintiff could estimate its lost profits by using the pre-breach profit history of its competitors" who sold a fungible drug. *Stuart Park Associates, Ltd* **v.** *Ameritech Pension Trust,* 846 F. Supp. 701, *aff'd* 51 F.3d 1319, 1328 (7th Cir. 1995).

Once again, not only do the facts presented here differ significantly from those in *Milex,* the *Milex* opinion actually cuts against MindGames' argument. The product at issue in *Milex* was not innovative but rather had the same active ingredients and worked as well as the innovator's products (*i.e.*, it was essentially a generic form of the original drug). In contrast, MindGames itself admits that *Clever Endeavor* was unique, not fungible.

- Q: Did you think any games were similar to yours?

> A: No. In my opinion ours was differentiated from other games. (Blackwell Dep. 93.)

- Blackwell prepared his 1989 sales projections on orders received at the 1989 Toy Fair and *Clever Endeavor's* reception in the marketplace, not on the sales history of any other game. (Blackwell Dep. 105.)
- Blackwell "think[s] every game is unique." (Blackwell Dep. 134)

MindGames not only invokes inapposite authority, it neglects to mention that the Seventh Circuit found a venture's past successes with a different product in the same business did not render the New Business Rule inapplicable:

> Summit argues vehemently that its successes with other apartment buildings should be considered as probative of [the profits that the proposed apartment complex would yield.] However, these are different pieces of real estate from different markets - not providing a self-evident basis for generalization.

Stuart Park, supra,. 5I F.3d at 1328. Although *Stuart Park* was decided under Illinois law, Illinois (like Arkansas) adheres to the New Business Rule.

1. Lost Royalties Are Lost Profits.

MindGames tries to elude the grasp of the New Business Rule by claiming that it is not asserting a claim for

lost profits. (MindGames' Br. at 2, 9-10.) This argument is simply disingenuous. MindGames' complaint states a claim for lost profits:

> The breaches of the agreement by Western and Games Gang, Ltd. have caused substantial damages, both present and future, to MindGames, ***including loss of profits*** and interference with MindGames' business relations.

(MindGames Cpt. at ¶ 8, attached hereto as Exhibit C.) Consistent with its complaint, MindGames' counsel recently characterized the damages MindGames seeks from lost future sales as lost profits:

> As to MindGames' claim for up to $40 million in ***lost future profits*** based on Western's and Games Gang's mishandling of *Clever Endeavor,* you will say we will not be able to seek such damages because Arkansas is a "New Business Rule" state. (See, February 22, 1996 letter from Camp Kersten to Wendi Sloane Weitman, attached hereto as Exhibit D.)

Even without its admissions to the contrary MindGames' attempt to create a distinction between "***profits***" and "***royalties***" would still be unsuccessful. MindGames invokes the Black's Law Dictionary definition of ***"profit"*** to support its claim that royalty income is not profit. (MindGames' Br. at 10). However, MindGames neglected to cite the Black Law Dictionary definition of

"royalty," which demonstrates the speciousness of MindGames' argument:

> Royalty is share of product or ***profit*** reserved by owner for permitting another to use the property. In its broadest aspect, it is share of ***profit*** reserved by owner for permitting another the use of property. *(Emphasis added)*

It is not surprising that MindGames cites no decision that draws a distinction between profits and royalties. The courts treat a claim for lost royalties as a claim for lost profits. *See, eg., Oral-X Corp.* **v.** *Farnam Companies, Inc.*, 931 F.2d 667, 670 (10th Cir. 1991) (reversing the district court's refusal to award damages for royalties as lost profits); *In re Mid-America Corp.*, 159 B.R. 48, 55 (M.D. Fla. 1993) (holding that the speculative nature and difficulty in determining the amount of lost profits precluded franchisor's recovery of damages for lost future royalties).

Blackwell's own deposition testimony also contradicts the claim that MindGames did not equate royalties with profit. During questioning concerning sales of the *Clever Endeavor* in Europe by foreign licensees, Blackwell described his expectations for the foreign versions of *Clever Endeavor:*

> That ***we would make a profit,*** because I wanted to make sure they [the licensees] made a profit and we would get a continuing ***royalty income***. . . . It was incremental income. There was very little cost income

> from our standpoint -- additional cost, I should say.

(Blackwell Dep. 51.) This testimony makes clear that, until he became aware of the New Business Rule, Blackwell himself considered royalty income to constitute profit to MindGames regardless of whether MindGames itself was incurring any costs of operation.

A. The Facts That *Clever Endeavor* Had No History of Profits And That *Clever Endeavor Is* An Entertainment Product Constitute Additional Reasons For This Court To Adhere To The New Business Rule.

In its initial brief, Western submitted legal and factual support for the argument that because MindGames had no profits prior to the License Agreement, it cannot obtain alleged lost future profits. In response, MindGames cannot and does not dispute that it earned no profits whatsoever prior to the License Agreement. Nor does it address the legal authority Western cites in support of this position. (See Western Br. at 16-17.)

Instead, MindGames takes issue with the proposition that the success of a new entertainment product is especially difficult to predict. MindGames misconstrues rather than refutes Western's argument. MindGames characterizes Western's argument as standing for the proposition that a plaintiff can never recover lost profits in the entertainment business. (MindGames' Br. at 16.) Yet this is not the argument Western advances. Rather in its initial brief, Western argued that, even if this Court were inclined to

retreat from *Marvell Light,* the facts of this case present a particularly inappropriate context in which to do so, given the capriciousness of the entertainment industry. (See Western Br. at 12.) MindGames now appears to take issue with the proposition that the success of entertainment products is particularly difficult to predict. MindGames fails to defend its position with either appropriate factual or legal support.

Ironically, MindGames first chastises Western for failing to produce "a shred of evidentiary support for its argument" (MindGames' Br. at 16.) In fact, Western cited both documentary and testimonial support for this argument (See Western Br. at 13-14, Appendix; Exh. A, H, I, J, N.)

MindGames then insinuates that Western's legal authority does not support its argument. (MindGames Br. 16-18). MindGames tries to distinguish only three of the cases Western cites. Each of these cases -- *Proteus Books Ltd v. Cherry Lane Music Co.,* 873 F.2d 502 (2nd Cir. 1989) (New York law), *Kenford Co. v. County of Erie,* 67 N.Y.2d, 493 N.E.2d 234 (1986) (New York law), and *Haddi Caddy, Inc. v. American Home Products. Corp.,* 557 F.2d 136 (8th Cir. 1977) (Missouri law) -- was decided in a jurisdiction that does not follow the New Business Rule. Western relies on these cases not for the proposition that the New Business Rule applies but instead for the premise that even in states rejecting the New Business Rule, it is difficult to prove lost profits in the entertainment industry. In each case, the court ***rejected*** the lost profits claims because of the speculative nature of the entertainment industry. Significantly, MindGames simply ignores the

Hillside Enterprises decision, discussed at length in Western's brief. (Western Br. at 14-15.)

Finally, MindGames misplaces its reliance on *Jim Halsey Co. v. Bonar, supra.* As discussed above, that case involved a preexisting business (a concert promoter), who presented evidence of his reputation, and ticket sales based on an average vacancy rate. These facts are very different from trying to predict the sales of a new adult board game, which its own inventor characterizes as "unique," by a company where that game was its "first and only product." (Blackwell Dep. 34,134.)

CONCLUSION

For the reasons cited in its initial brief and herein, Western respectfully requests that this Court grant its motion for partial summary judgment and find that MindGames cannot recover its alleged lost profits as a matter of law.

EXCERPTS from

UNITED STATES DISTRICT COURT

FOR THE EASTERN DISTRICT OF WISCONSIN

WESTERN PUBLISHING COMPANY, INC.,

Plaintiff,

v. Case No. 94-C-552

MINDGAMES, INC.,

Defendant.

MINDGAMES, INC.,

Plaintiff,

v. Case No. 94-C-998

WESTERN PUBLISHING COMPANY, INC.,

Defendant.

AFFIDAVIT OF G. LAWRENCE BLACKWELL, III, IN OPPOSITION TO THE SUMMARY JUDGMENT MOTION OF WESTERN PUBLISHING COMPANY, INC.

CONTRACT BREACHES BY WESTERN AND GAMES GANG

26. Western breached ¶ 8 of the license agreement (App. 32-33) in the area of its manufacturing responsibilities, including the following:

a. Western negligently printed 50,000 boxes in an incorrect color with poorly printed box wraps. It nevertheless insisted on selling them because of tight schedules. The unappealing boxes caused confusion and dissatisfaction among retailers and consumers in *Clever Endeavor*'s start-up year.

b. Western knowingly sold *Clever Endeavor* games with defective board pieces it had purchased at a 50% discount without timely disclosing to MindGames either the defects or the discount. This also proved very damaging to *Clever Endeavor* in its critical start-up year.

c. Western sold numerous games with missing components, such as game rules, board pieces and venture cards, and with incorrectly cut and duplicated clue cards.

27. Western and Games Gang committed numerous breaches of the license agreement with respect to their promotion, sales and marketing obligations which proved fatal

for *Clever Endeavor*. In October 1990, *Clever Endeavor*'s mass market launch season, Games Gang fired its chief executive officer and president, its chief financial officer and its vice president of marketing and did not replace them. Its only remaining executives had no significant marketing experience. It appeared to me that Western took no steps to rectify the effects of these events on *Clever Endeavor*. The known breaches of contract and performance warranties in the area of marketing on the part of Western and Games Gang include the following:

a. Unknown to MindGames, in May 1990 Games Gang proposed lowering its sales force's commissions on *Clever Endeavor*, reducing their incentive.

b. Without MindGames' consent and without adequate funds, Games Gang promised retailers television ads. Retailers ordered in reliance on this. Games Gang then reneged, causing retailers to cancel orders in large numbers.

c. Without obtaining MindGames' required consent, retailers were notified on December 31, 1990 of a price increase of nearly 17%. A "correction letter"

cancelling the increase was not sent until three months later.

d. Games Gang ran *Clever Endeavor* ads for the critical mass market introductory Christmas season of 1990 late. This caused retailers to panic and seek to escape from an over-inventory position. The late advertising also greatly reduced reorders.

e. Radio ad campaigns in important markets like Chicago and Minneapolis were poorly handled. Ads ran too long and became stale and were not as represented.

f. Ad funds were wasted by running ad campaigns on wrongly-targeted radio stations (as if advertising a rock-related product on an "elevator music" station).

g. Games Gang permitted the public relations firm it selected to fail to perform promised public relations activities.

h. In 1990, 1993 and 1994 Western and Games Gang failed

to spend the minimum amount for advertising required by the license agreement.

i. In 1991, 1992 and 1993 Western ignored MindGames' requests for information on planning and execution of ad campaigns.

j. Western repeatedly gave preference over *Clever Endeavor* in manufacturing and distribution to its other games. This also occurred with respect to derivative *Clever Endeavor* products such as a second edition and a children's edition. MindGames believes this was due to the higher royalties payable on *Clever Endeavor*.

MINDGAMES' DAMAGE CLAIMS

28. I am informed that Western's summary judgment motion attempts to bar MindGames, Inc., from seeking "lost profits" on the ground that Arkansas law does not permit a "new business" to recover "lost profits." MindGames does not claim "lost profits" in this case but rather claims loss of royalties (and other damages) based upon the failure of Western and its co-licensee, Games Gang, to fulfill their obligations under the license agreement.

MindGames' damage claims at the present time are set forth below.

29. MindGames' first claim for royalties is based upon the fact that Western continued to manufacture and sell *Clever Endeavor* throughout 1993, after the initial three-year term of the license. MindGames believes that Western became obligated under the license agreement to pay MindGames the difference between $1.5 million and the royalties actually paid during the first three years by so doing. Despite Western's recent invention, there was no agreement to the contrary and MindGames relied on the 1990 agreement. Western has paid royalties to date of approximately $535,000 for that period. It therefore still owes MindGames approximately $965,000, plus interest. MindGames has never waived its claim to these royalties.

30. MindGames' second claim for royalties is based upon the fact that Western continued to manufacture and sell *Clever Endeavor* through June of 1994, after the first one-year license extension period. By selling the game through a second extension period Western became obligated to pay MindGames additional royalties on sales during the first one-year extension. Western has paid only part of this obligation and owes MindGames the balance, plus interest. Sales made by Western subsequent to January 31, 1994 were not pursuant to a permitted liquidation. Further, most unit sales for the year ending January 31, 1995 occurred after any such liquidation period would have expired. MindGames has not waived its claim to these royalties.

31. MindGames' third claim for royalties is based upon the fact that Western sold about 61,000 copies of *Clever Endeavor* in June 1994. The royalties payable to MindGames on these sales have not all been paid. The balance is owed to MindGames, plus interest.

32. MindGames' fourth damage claim is based upon the fact that Western breached its obligation to obtain MindGames' consent to sell games for less than $16.95 per game when it liquidated many thousands of copies of the game at $4. MindGames did not consent and would not have consented to such a liquidation because of its destructive effect. This liquidation destroyed *Clever Endeavor* as a commercially viable game and any possibility of licensing it to another business was substantially impaired.

33. MindGames further claims damages for Western's failure to disclose material facts regarding Western's assumption of Games Gang's contractual obligations. As required by the license agreement, Western obtained MindGames' permission to assume all of Games Gang's obligations and benefits under the license agreement in 1992. Western failed to disclose, however, that it had to give up a substantial percentage of commissions to Games Gang on all future sales. This seriously impaired Western's incentive to aggressively market *Clever Endeavor*. Western and Games Gang had already expressed to me their concern about "low profits." Had MindGames known the assumption agreement would reduce the profitability of *Clever Endeavor* for Western, MindGames would not have consented to those terms.

34. MindGames also claims damages based upon Western's failure to spend required amounts on advertising and promotion. It owes MindGames 50% of all such unspent funds. The amount of this claim is undetermined at this time, pending further discovery.

35. MindGames' largest damage claim (the only one addressed by Western's motion for summary judgment) is based upon the multiple breaches of contract by Western and Games Gang in manufacturing and marketing *Clever Endeavor* referred to above, the effect of which was to destroy the value of the game in the marketplace and to prevent it from reaching even a fraction of the potential that was widely recognized for it when the license agreement was entered into. The accumulation of breaches by Western and Games Gang made it impossible for *Clever Endeavor* to reach more than a small fraction of the royalty income it had been well on its way toward generating. MindGames' damages for this element are substantial and depend on how closely the jury believes *Clever Endeavor* would have approached the royalty levels of *Pictionary* and *Trivial Pursuit* had it been handled as the licensing agreement required.

EXCERPTS from

UNITED STATES DISTRICT COURT

FOR THE EASTERN DISTRICT OF WISCONSIN

WESTERN PUBLISHING COMPANY, INC.,

Plaintiff,

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MINDGAMES, INC.,

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WESTERN PUBLISHING COMPANY, INC.,

Defendant.

SUPPLEMENTAL AFFIDAVIT OF G. LAWRENCE BLACKWELL, III, IN OPPOSITION TO (1) NEW ISSUES RAISED IN WESTERN'S SUMMARY JUDGMENT REPLY BRIEF, (2) WESTERN'S RESPONSES TO MINDGAMES' PROPOSED FINDINGS OF FACT AND (3) WESTERN'S MOTION TO STRIKE SUMMARY JUDGMENT AFFIDAVIT

(b) ¶ 24. Based upon my personal observation and experience as president of MindGames, I know that an estimate of sales will provide an accurate estimate of MindGames' damages because MindGames received royalties based upon sales at virtually no cost to itself. As a businessman, I am aware that sales predictions can be made based upon reasonable supporting evidence. I know that Western made sales predictions for *Clever Endeavor* on which it based its game inventory buildup for supplying the market and avoiding product shortages. Western undoubtedly made such sales predictions for its games every year since at least 1990. WP-1604 (App. 1) shows that in or before April of 1991 Western and Games Gang made sales predictions for their jointly handled games for fiscal 1993. Furthermore, WP-2040 (App. 4) shows that Western predicted its profit on *Clever Endeavor*. Western has not provided unredacted copies and supporting detail for either its own or Games Gang's forecast of *Clever Endeavor* profits after it licensed the game, but WP-1793 and 1794 (App. 6 and 7) indicate the forecasts were made.

Excerpts from

MEMORANDUM OF MINDGAMES, INC., IN OPPOSITION TO MOTION FOR SUMMARY JUDGMENT OF WESTERN PUBLISHING COMPANY, INC.

It is important to keep the point of Western's summary judgment motion in sharp focus. It is that the new business rule prevents MindGames from proving "lost profits" as a matter of law. Western argues, in other words, that Arkansas law does not allow MindGames even to attempt to prove the fact and/or the amount of its damage simply because MindGames itself is a new business. (From p. 2.)

* * * * *

Under the applicable law cited later in this brief it is MindGames' obligation to prove its damages to a reasonable certainty. MindGames acknowledges its obligation to establish its claims by appropriate evidence beyond the boundary of speculation and guesswork and looks forward to the opportunity to do so. Meanwhile, Western has not proposed a single fact or offered any evidence beyond the mere unsupported opinions of its lawyers establishing that, as a matter of law, MindGames will be unable to fulfill its burden. On this motion we are not arguing the sufficiency proof, but whether MindGames has the right to present proof. Clearly it has that right, which requires denial of the motion for summary judgment. (From pp.3-4.)